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INTERNATIONAL COUNTERTRADE

Draft Legal Guide on International Countertrade Transactions

Report of the Secretary-General

Addendum

III. CONTRACTING APPROACH

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[Editorial note: The present draft chapter III is a revision of draft chapter bearing the same title and published in document A/CN.9/332/Add.2. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/332/Add.2 or that the paragraph is new. The revisions of paragraphs that appeared in A/CN.9/332/Add.2 are underlined. An asterisk indicates the place where text has been deleted without adding new language. The whole section C is new.]

A. Structure of countertrade transaction [change of title]

1. [1] A preliminary question the parties have to address is the contract structure of the countertrade transaction. The parties may embody the obligations in regard to the shipments of goods in the two directions in one contract or they may embody those obligations into separate contracts. (For the discussion of the structure of the countertrade transaction and related insurance and financing considerations, see below, paragraphs 8 and 9, and section C.)

1. Single contract

2. [2] Under a single-contract approach the parties conclude one contract for the supply of goods in the two directions. Such a single contract may take the form of a barter contract (below, paragraphs 3 to 8) or the form of a merged contract (below, paragraphs 9 and 10). *

(a) Barter contract

3. [3] As noted in chapter II, "Scope and terminology of Legal Guide", paragraph 14, the Legal Guide uses the term barter in its strict legal sense to refer to a transaction involving an exchange of goods for goods, so that the supply of goods in one direction entirely or partly replaces the monetary payment for the supply of goods in the other direction. In a barter contract there is no need for a countertrade commitment since the parties agree at the outset of the transaction on all the contract terms for the shipments in the two directions. If the goods to be supplied in one direction are agreed to be of the same value as the goods to be supplied in the other direction, no monetary payment would be made. If the values are agreed to be different, the difference may be settled by monetary payment or by delivery of additional goods. The parties may or may not express the value of the goods in monetary terms. If they do so, the attachment of a price to the goods serves to compare the value of the deliveries. The parties may have to express the value of shipments in monetary terms due to customs or other administrative requirements.

[5]*

4. [7] Under a barter contract the quantity of goods to be shipped in one direction is often measured by the quantity of goods to be shipped in the other direction, rather than in terms of the market price for each shipment. The absence of a price in a barter contract or the use of prices that do not reflect the market prices might cause a difficulty when non-conforming goods

are delivered under a barter contract. If in such a case monetary compensation is regarded as the appropriate relief, the absence in the contract of a market price, or of any price at all, could lead to disagreement over the amount of the compensation due. The stipulation of a price other than the market price may also give rise to a difficulty in calculating customs duties when they are based on the market value of the goods.

5. [4] A factor that is often the main reason for using barter is that the use of barter eliminates or reduces the need for currency transfers. It may be noted, however, that the avoidance of currency transfers may also be achieved through the use of other contractual forms, namely, the parties may conclude separate sales contracts in each direction and agree to set off their payment claims under the contract (such setoff of mutual claims is discussed in chapter IX, "Payment", paragraphs   to   ).

6. [6] A possible difficulty in a barter contract may be a risk that the party who has shipped goods does not receive the agreed goods from the other party. Payment against the presentation of shipping documents or the opening of a documentary letter of credit, devices used with other types of contracts to address an analogous risk in other types of contracts, cannot be used in barter since neither delivery is payable in money. One way of addressing this risk may be to agree that the deliveries are to be made simultaneously, to the extent it is practical for the parties to coordinate ther deliveries in this way. If simultaneous deliveries are agreed upon, the contract may clarify that, if one of the parties is not prepared to deliver on schedule, the other party would be entitled to withhold its delivery or to terminate the contract if the delay exceeds a specified period of time. The contract may also provide that the party who has breached its obligation to deliver at the agreed time must compensate the other party for loss arising from the delay or termination of the contract. The parties may address in the contract the question of which outlays or losses are to be compensated (e.g., warehousing costs, costs related to transportation, or a specified amount of overhead costs).

7. [6] The risk that the other party will not ship the agreed goods may also be overcome by providing for an independent guarantee to assure the party who has shipped of compensation in the event that the other party fails to ship (the use of guarantees for this purpose is discussed in chapter XII, "Security for performance", paragraphs __ and __). If a party finds it costly or is unable to provide such a guarantee, it may be agreed that that party is to deliver goods first. Insurance might be another possible means of limiting the risk that the risks that affect the party who has shipped first and thus "prepaid" the goods to be delivered subsequently by the other party (se below, paragraph 52).

8. [new paragraph] If the right of a party to receive goods in return for its delivery is not sufficiently secured, in particular by an independent bank guarantee, that party may find it difficult to obtain financing for the transaction from a bank or from a governmental credit agency. The entity providing financing may be reluctant to provide financing to the extent the profitability of the transaction and the ability of the party seeking credit to repay the credit depends on an unsecured obligation to deliver goods of the agreed quality.

(b) Merged contract

9. [8] The term "merged contract" is used to describe the case in which the two contracts, one for the delivery of goods in one direction and the other for the delivery of goods in the other direction, are merged into one comprehensive contract. The merged contract thus embodies all the terms covering the obligations of the parties to ship goods to each other and to pay for the goods they have received. The difference between a barter contract and a merged contract is that, under a barter contract, the delivery of goods in one direction constitutes payment for the delivery of goods in the other direction, while, under a merged contract, each delivery of goods gives rise to a monetary payment obligation. If the parties agree to set off their claims for payment under a merged contract, the difference between a merged contract and a barter contract * would be diminished in that in either case no transfer of money takes place or only the balance of the values of the deliveries in the two directions is transferred. As in barter, there is no need in a merged contract for a countertrade commitment since the deliveries to be made in the two directions are covered by definite contract terms.

10. [9] It appears that many legal systems are likely to give weight to a merger of the mutual obligations in determining the degree of interdependence between contract obligations for the deliveries of goods in the two directions. * Unless the parties provide in the contract that certain obligations regarding delivery in one direction are to be performed irrespective of non-performance of an obligation regarding delivery in the other direction, the mutual obligations are likely to be considered interdependent. The consequence of such interdependence would be that non-performance of an obligation such as non-delivery, refusal to take delivery, or non-payment relating to a shipment in one direction might be invoked as a reason for suspending or refusing performance in the other direction. Furthermore, termination of an obligation in one direction, whether or not a party is responsible for the termination, may be interpreted as entitling a party to terminate an obligation in the other direction. (Such interdependence of obligations may affect the ability of a party to insure the payment claim arising from its delivery of goods and to obtain financing for the delivery, see below, paragraph 51). If the parties using a merged contract approach wish to keep the obligation to ship goods in one direction and the corresponding payment obligation independent from the obligations relating to the shipment in the other direction, they should use unambiguous language to that effect. A related discussion of possible interdependence between the export contract and the countertrade agreement is contained below in paragraphs 17 to 19. Further discussion on the question of interdependence of obligations is found in chapter XIII, "Failure to complete countertrade transaction", paragraphs to .

2. Separate supply contracts [change of title]

11. [10] When the parties use separate contracts for the shipments in the two directions, they would use one of the following approaches:

(a) the export contract and the countertrade agreement are concluded simultaneously and the counter-export contract is concluded subsequently;

(b) the countertrade agreement is concluded prior to the conclusion of any definite supply contracts;

(c) the separate supply contracts for the shipment in each direction and the countertrade agreement establishing a relationship between them are concluded simultaneously.

12. [11] The obligation to ship goods in a particular direction in a countertrade transaction may be fulfilled by two or more different contracts, which may involve different buyers and sellers. While such a situation affects the contractual structure of a given transaction, it does not affect the nature of the discussion in this chapter. Therefore, references in the singular to a supply contract, as well as to an export or counter-export contract, also cover the situation in which more than one contract is concluded for the shipment of goods in a particular direction.

(a) Export contract and countertrade agreement concluded simultaneously

13. [12] The parties often finalize a contract for the shipment in one direction (export contract) before they are able to reach agreement on the contract for the shipment in the other direction (counter-export contract). Parties using this contracting approach may face a broad range of issues specific to countertrade. In order to ensure conclusion of the counter-export contract, the parties conclude, simultaneously with the conclusion of the export contract, a countertrade agreement containing the commitment to conclude the counter-export contract. The primary purpose of the countertrade agreement in such cases is, in addition to stating the countertrade commitment, to outline the terms of the future contract and to establish procedures for concluding and carrying out supply contracts. Possible issues to be addressed in such a countertrade agreement are enumerated below in paragraphs 29 to 33.

14. [13] The contents of the countertrade agreement would be influenced by the degree to which the parties are able to define the terms of the future contract. It is advisable that the countertrade agreement be as definite as possible concerning the terms of the future contract, in particular regarding the type, quality, quantity and price of the countertrade goods, in order to increase the likelihood that the countertrade commitment will be fulfilled. To the extent that the parties are not in a position to settle the terms of the counter-export contract in the countertrade agreement, they are advised to establish guidelines within which the terms are to be agreed upon and to lay down procedures for negotiation (for the discussion on the definiteness of the countertrade commitment see chapter IV, paragraphs 38 to 60). In any case, it is advisable to settle in the countertrade agreement the time period within which the countertrade commitment should be fulfilled (see chapter IV, paragraphs 7 to 20).

15. [14] The content of the countertrade agreement would also be influenced by the degree of interest the parties have in the shipments in the two directions. In many cases the exporter is primarily interested in the conclusion of the export contract, and the countertrade commitment results primarily from a desire to secure the export contract. In other cases, the importer purchases goods from the exporter in order to enable the exporter to finance the counter-import. In yet other cases, each side is particularly

interested in obtaining the goods being offered by the other side. Because the interests of the parties vary in such a manner, the content of the countertrade agreement may vary from case to case with respect to issues such as sanctions for non-fulfilment of the countertrade commitment, payment mechanisms, procedures for concluding the future contract and for monitoring fulfilment of the countertrade commitment, and interdependence of obligations.

16. [15] The simultaneous conclusion of an export contract and a countertrade agreement is an approach frequently used in counter-purchase, buy-back or offset transactions. In the case of the counter-purchase transaction, the parties may not yet know what type of goods would be counter-exported. In the case of a buy-back, the parties may not be able to agree on such terms as price or quantity because of the long time period between the conclusion of the contract for the export of the production facility and the beginning of production of resultant products. In an offset transaction, the parties may not know what type of goods will be counter-exported or the identity of the counter-exporters.

17. [16] The use of this contracting approach raises the question whether to include the terms of the countertrade agreement in the export contract or to embody those terms in a separate instrument. The choice of the parties in this regard may have an effect on the degree to which the obligations stipulated in the export contract and the obligations set forth in the countertrade agreement are considered to be interdependent. When there is such interdependence, a delay in the fulfilment or non-fulfilment of the countertrade commitment may provide the importer with a justification for suspending payment of the amounts due under the export contract or for deducting corresponding damages from the payment due under the export contract. Similarly, the exporter may regard a delay in payment for the export contract as a ground for delaying fulfilment of the countertrade commitment. Furthermore, delayed payment under the counter-export contract might prompt the importer to delay payment under the export contract. (Such interdependence of obligations may affect the ability of the exporter to insure its payment claim under the export contract and to obtain financing; see below paragraphs 51 and 53.)

18. [17] If the export contract and the countertrade agreement are embodied in separate contractual instruments, it appears that many legal systems would consider the two sets of obligations to be independent, except to the extent specific contract provisions establish interdependence. In other legal systems the export contract and the countertrade agreement may, despite the use of separate instruments, be considered to be interdependent on the ground that the obligations of the parties embodied in the two instruments form part of a single transaction. When the parties wish to avoid interdependence of obligations between the export contract and the countertrade agreement, or when they wish to limit interdependence to particular obligations, it is advisable that they embody the export contract and the countertrade agreement in separate instruments. When, despite the use of separate instruments, it is uncertain whether the obligations under the export contract and the countertrade agreement would be considered independent, it is advisable that the independence of the two sets of obligations be clearly expressed in the countertrade agreement.

19. [18] The parties may wish to establish, by express contract clauses, an interrelationship between particular obligations arising out of the export contract and out of the countertrade agreement, while keeping other obligations independent. The parties may, for example, agree that * the termination of the export contract permits the exporter to terminate the countertrade agreement, and that non-fulfilment of the countertrade commitment by the counter-importer entitles the counter-exporter to deduct an agreed amount as liquidated damages or penalty from payments due under the export contract. Further discussion on the question of interdependence is found in chapter XIII, "Failure to complete countertrade transaction", paragraphs ___ to ___.

(b) Countertrade agreement concluded prior to conclusion of definite supply contracts

20. [19] The conclusion of a countertrade agreement may be the first step in the transaction prior to the conclusion of any definite supply contracts in either direction. The aim of the countertrade agreement in such a case is to express the commitment of the parties to conclude supply contracts in the two directions and to establish procedures for concluding and implementing those contracts.

21. [19] In order to achieve the envisaged level of shipments in the two directions, it is advisable that the countertrade agreement be as definite as possible concerning the terms of the contracts to be concluded in the two directions (see chapter IV, "Countertrade commitment", paragraphs 38 to 60). The parties may also wish to establish mechanisms for monitoring and recording the progress made in achieving the agreed upon level of trade (chapter IV, paragraphs 61 to 74) and to provide sanctions for a failure to fulfil the countertrade commitment (chapter XI, "Liquidated damages and penalty clauses" and chapter XII, "Security for performance"). The need for sanctions may be diminished if the parties agree that their countervailing claims for payment for the shipments in each direction will be set off rather than paid for individually (see chapter IX, "Payment", paragraphs ___ to___). Such a payment mechanism would provide an incentive to both parties to order goods from each other and thereby attain the level of trade envisaged in the countertrade agreement. The incentive is derived from the fact that a party who has shipped goods will be stimulated to order goods from the other party in order to be compensated for its own deliveries. Furthermore, the parties may wish to address in the countertrade agreement the question of independence of the contracts in the two directions (see chapter XIII, paragraphs ___). These and other issues that the parties may wish to address in a countertrade agreement entered into prior to the conclusion of any supply contract are set out below in paragraphs 29 to 39.

(c) Export contract, counter-export contract and countertrade agreement concluded simultaneously

22. [20] When the parties simultaneously conclude a contract for the supply of goods in one direction and another contract for the supply of goods in the other direction, and there is no indication in the contracts that there is a relationship between them, the contracts would appear on their face to be independent of one another even if one party or both parties regarded the conclusion of one contract as a condition for the conclusion of the other contract. When, however, the parties wish to give contractual effect to an

intention that the conclusion of one contract be conditioned upon the conclusion of the other, i.e., when they wish to structure the contracts in the two directions as a countertrade transaction, the parties should conclude a countertrade agreement expressing that relationship.

23. [21] This contracting approach raises a limited number of issues since it does not involve a countertrade commitment. The main issue in this contracting approach is the manner in which the obligations of the parties with respect to the shipments in the two directions are to be linked by provisions in the countertrade agreement. There is no need to deal in the countertrade agreement with various issues related to the fulfilment of the countertrade commitment (in particular the type, quality, quantity or price of the countertrade goods, time schedules of fulfilment of countertrade commitment, security of performance or liquidated damages or penalties supporting the countertrade commitment). The issues that the parties may wish to address in a countertrade agreement concluded simultaneously with the definite supply contracts in the two directions are set out below in paragraphs 40 to 42.

B. Contents of countertrade agreement

24. [new paragraph] Matters of particular importance for the structure and implementation for countertrade transactions are dealt with in the countertrade agreement. While the Legal Guide concentrates on issues to be addressed in the countertrade agreement, where necessary, reference is made in the Guide to drawing up a provision in a supply contract that is influenced by the fact that the contract is part of the countertrade transaction. The following subsections 1 and 2 provide an outline of a possible content of a countertrade agreement, depending upon whether or not the countertrade agreement includes a countertrade commitment.

25. [new paragraph] A countertrade agreement with a countertrade commitment is used when the parties envisage concluding in the future one or more counter-export contracts, or when the parties envisage concluding in the future supply contracts in the two directions (cases (a) and (b) referred to above in paragraph 11). A countertrade agreement without a countertrade commitment is used when the parties have entered, at the outset of the transaction, into the contracts for the supply of goods in the two directions and there is therefore no need for a countertrade commitment (case (c) referred to above in paragraph 11).

26. [new paragraph] The content of a countertrade agreement involving a countertrade commitment is usually more complex and gives rise to more negotiation and drafting difficulties than a countertrade agreement without a countertrade commitment. The reason for the complexity and difficulty is that usually the parties, at the time of agreeing that they will in the future conclude a supply contract, are usually not in a position to specify, with sufficient definiteness, all the terms of the future contract. Lack of definiteness may make it difficult for the parties to draw up a countertrade agreement that will provide a sufficient assurance that the negotiations for the conclusion of a supply contract, containing terms acceptable to both parties, will be successful. The question of the definiteness of the countertrade commitment is discussed in chapter IV, paragraphs 38 to 60.

27. [Based on para. 26 of draft chapter II, A/CN.9/332/Add.1] Some of the issues listed below and discussed in the following chapters of the Legal Guide are essential in establishing a countertrade transaction that involves a countertrade commitment. For example, the parties would have to choose a contracting approach, express their commitment to engage in reciprocal trade, specify the extent of the commitment and the time frame within which the commitment should be fulfilled.

28. [Based on para. 26 of draft chapter II, A/CN.9/332/Add.1] Solutions to certain other issues listed below and dealt with in the Legal Guide, while not necessarily essential, would help to ensure proper implementation of the transaction. The parties will have to judge whether and to what extent various contractual issues discussed in the Legal Guide are relevant to the circumstances of the given case. Generally, it is advisable to settle in the countertrade agreement issues that the parties consider relevant since national legislations are likely not to have rules on issues specific to countertrade.

1. Countertrade agreement with countertrade commitment

29. [22] Countertrade commitment. The essential feature of a countertrade commitment is a stipulation by which the parties undertake to * conclude one or more supply contracts in one or in the two directions. In order to add definiteness to the commitment and increase the likelihood of its fulfilment, parties often include in the countertrade agreement provisions concerning terms of the anticipated contract, sanctions for the failure to conclude the supply contract, and other provisions to ensure the proper carrying out of the countertrade transaction. Various aspects of the countertrade commitment are discussed in chapter IV.

30. [23] Type, quality and quantity of goods. In order for the countertrade commitment to be meaningful, it is particularly important that the countertrade agreement be as specific as possible as to the type, quality and quantity of the countertrade goods. Clauses in the countertrade agreement addressing these issues are discussed in chapter V.

31. [24] Pricing of goods. Since the parties are often not in a position to set the price of the countertrade goods at the time the countertrade agreement is concluded, they may establish guidelines and procedures for setting the price at a later date. Such provisions help to prevent delays in the conclusion of supply contracts and provide pricing flexibility in long-term countertrade transactions. Issues relating to pricing clauses are addressed in chapter VI.

[25] *

32. [26] Participation of third parties [change of heading]. The parties may wish to involve third parties, either as suppliers or purchasers, or both, of countertrade goods. In such cases it is advisable that the countertrade agreement contain provisions concerning participation by third parties. Those provisions could determine the manner in which a third party would be selected, whether the third party is to become bound to fulfil the countertrade commitment and the legal effect of the involvement of the third party on the obligations undertaken by the parties to the countertrade

agreement. Issues to be dealt with in the countertrade agreement relating to participation of third *parties* are discussed in chapter VIII.

33. [27] *Payment*. When payments for the shipments in each direction are kept independent, no payment issues specific to countertrade are raised. However, when the parties wish to link the payments for the shipments in the two directions so that the proceeds of the contract in one direction are used to pay for the contract in the other direction, they would have to include in the countertrade agreement provisions on the manner in which payment is to be linked. A discussion of contractual aspects of various types of linked payment mechanisms is found in chapter IX.

34. [28] *Restrictions on resale of goods*. The freedom of a party to resell goods purchased in a countertrade transaction may sometimes be restricted by contractual agreement between the supplier and the purchaser of the goods. The purchaser may be restricted, *for example,* as to the territory of resale, * resale price or packaging. Clauses in the countertrade agreement concerning such *resale* restrictions, *as well as the question of the legality of such clauses,* are discussed in chapter X.

35. [29] *Liquidated damages and penalties*. In order to limit disagreements as to the extent of damages resulting from a breach of the countertrade commitment, the countertrade agreement may stipulate a sum of money, *specified as liquidated damages or a penalty*, due from a party upon failure to fulfil the commitment to purchase or make available countertrade goods. The use of such clauses in a countertrade agreement is addressed in chapter XI. *In paragraph of that chapter it is pointed out that the use of a penalty, as opposed to liquidated damages, is not permitted in a number of legal systems.*

36. [30] *Security for performance*. The parties may use guarantees to support fulfilment of the countertrade commitment, as well as the proper performance of individual supply contracts concluded pursuant to the countertrade commitment. The use of guarantees to support the fulfilment of the countertrade commitment, or the obligation to pay under a liquidated damages or penalty clause, raises issues to be addressed in the countertrade agreement. In transactions in which the parties limit payments in cash by exchanging goods for goods or setting off countervailing payment claims, the countertrade agreement may stipulate the use of guarantees to cover liquidation of an imbalance in the flow of trade. Issues to be addressed in the countertrade agreement when the parties wish to use guarantees to support fulfilment of the countertrade commitment and liquidation of an imbalance in trade are discussed in chapter XII.

37. [31] *Failure to complete countertrade transaction*. *The parties may wish to deal in the countertrade agreement with various issues relating to the possibility of a failure to complete the transaction. These issues include possible release of a party from its obligations under the countertrade commitment, monetary compensation, exempting impediments and interrelationship of obligations.* Provisions of this type are examined in chapter XIII.

38. [32] *Choice of law*. *It is advisable that the parties* agree upon the law to be applied to the countertrade agreement *and* to the supply contracts. Provisions of this nature are discussed in chapter XIV.

39. [33] Settlement of disputes. It is advisable that the parties address in the countertrade agreement the manner in which disputes are to be settled. Chapter XV examines issues to be considered in preparing dispute settlement clauses.

2. Countertrade agreement without countertrade commitment

40. [34] When the parties simultaneously conclude separate contracts for the entire supply of goods in the two directions, there is no need for a countertrade agreement containing either a countertrade commitment to conclude future contracts, or clauses on the type, quality, quantity or price of the goods, liquidated damages or penalties to be paid for failure to conclude supply contracts, or guarantees to support the countertrade commitment.

41. [35] The primary purpose of the countertrade agreement in this case would be to establish a link between the contracts in the two directions, namely, that the conclusion of a contract in one direction is conditioned upon the conclusion of a contract in the other direction. The countertrade agreement may provide that a problem in the performance of one contract would have an effect on the obligation to perform the contractual obligations in the other direction (clauses establishing a link of this type are discussed in chapter XIII). The parties may also establish a link between the contracts by structuring payment for the two contracts in such a way that the proceeds of the shipment in one direction would be used to pay for the shipment in the other direction. Linked payment mechanisms of this type are discussed in chapter IX.

42. [36] In addition, the countertrade agreement may address issues such as restrictions on the resale of countertrade goods (chapter X), participation of third persons in the countertrade transaction (chapter VIII), choice of law (chapter XIV) and settlement of disputes (chapter XV).

C. Insurance and financing considerations

[Editorial note: the whole section C is new.]

43. Criteria and procedures relevant to obtaining export credit insurance or financing are largely the same for a contract forming part of a countertrade transaction as they are for a straightforward export transaction. Therefore, the Legal Guide does not discuss comprehensively export credit insurance and financing. However, to the extent credit-insurance and financing considerations are relevant to the structure of countertrade transactions, this subsection discusses those considerations.

44. In many countries a party exporting goods, services or technology may obtain insurance against the risk that the payment claim arising from the export will not be paid. In some countries such insurance schemes are run or supported by State owned entities. In addition, many private insurance companies engage in such insurance. Insurance coverage usually starts when the exporter ships the goods. If the exporter is to manufacture goods designed specifically for the buyer, some insurers might also be prepared to cover the risk that the buyer will fail to take delivery of the goods when they are manufactured and made ready for delivery.

45. Insurable commercial risks might include the insolvency of the importer, repudiation by the importer of the contract prior to the shipment of the goods, and refusal of the importer to take delivery of the goods. Insurable non-commercial risks might include import restrictions by the State of the importer; exchange control regulations in the importer's country that prevent payment to be made or prevent use of the agreed currency; cancellation of import licence that had been properly issued; war, civil insurrection or similar conditions in the buyer's country that prevent the performance of the contract; other causes that are outside the control of the exporter and importer and that arise from events outside the exporter's country.

46. Insurance cover may be negotiated for a specific transaction or, on a broader basis, for all contracts for a certain type of merchandise concluded over a specified period of time by the exporter or by a group of exporters. The latter approach, based on turnover of goods, has the advantage of spreading the risk over a number of contracts and thereby reducing the premium.

47. Several salient principles, which are related to principles found in insurance generally, may be noted with respect to export credit insurance. One principle is that export credit insurance is a risk sharing scheme. The insurer will typically assume only a portion of the non-payment risk, while the rest of the risk must be borne by the insured exporter. The insurable portion of the risk depends on the type of risk involved and, if the insurer is a State agency, on the extent to which the State wishes to stimulate exports. Another principle is that the exporter is obligated to inform the insurer, to the best of its knowledge, of all facts that may affect the degree of the non-payment risk. A further principle is that the insured exporter must take all steps in its power to ensure that the contract for the export of goods is validly concluded and that it remains valid and enforceable.

48. Yet another principle is that, if the importer fails to pay the insured claim or if the enforceability of the claim becomes doubtful, the exporter must take all steps to minimize loss and to secure or enforce the payment claim. The insurer will typically require that it be informed of any difficulty that has arisen or is imminent regarding payment to be made under the insured contract. In addition, the insurer will usually require that it be consulted about steps to be taken to secure or enforce the payment claim and that it be entitled to approve certain steps. The readiness of the insurer to provide insurance cover and the amount of the premium will depend on the security that the importer is ready to provide in support of its payment obligation. Such security may be, for example, an irrevocable documentary letter of credit, a bill of exchange or a promissory note, with a third party guaranteeing payment of the bill or note, or an independent bank guarantee.

49. The objective of securing the insured payment claim may be achieved in a countertrade transaction by linking the insured claim to the claim arising from the supply contract in the other direction. As discussed in chapter XIII, "Failure to complete countertrade transaction", paragraph ___, in some countertrade transactions it is agreed that the exporter, if the importer fails to make payment under the export contract, is entitled to take possession and sell the goods that are to be delivered by the importer (counter-exporter) to the exporter (counter-importer). The proceeds of the sale are used to cover the exporter's outstanding claim. Since such an

arrangement may reduce the risk of non-payment under the export contract, it may be easier for the exporter to obtain insurance and financing for the export contract. When a bank has provided financing to the exporter, it may be agreed, in order to provide security to the bank for the financing provided to the exporter, that the bank itself is to obtain a security interest in the counter-export goods.

50. A further principle applicable to the export credit insurance is that the insurer must be satisfied that in the normal course of events, i.e. if the exporter meets its obligations under the export contract, the importer will have no reason to refuse to pay the amount due under the export contract. Insurers wish to avoid situations where payment under the insured contract may become dependent on an event that is extraneous to the insured contract and that may be difficult for the insurer to assess.

51. The principle referred to in the previous paragraph is relevant to the case when the insured export contract forms part of a countertrade transaction. The question may arise whether the payment obligation under the export contract depends only on the performance of the export contract or whether the importer can suspend or withhold payment because of a failure of the exporter to conclude or perform a supply contract in the other direction. A source of particular concern is the possibility that payment may be suspended or withheld even if the exporter (counter-importer) claimed that the reason for the failure to conclude or perform a counter-import contract was one for which the exporter was not responsible. For example, the exporter may refuse to conclude a counter-import contract because the quality or the price of the offered countertrade goods is not acceptable in light of what was stipulated in the countertrade agreement. The possibility of such disagreement over the responsibility for non-fulfilment of the countertrade commitment is increased when the parties to the countertrade transaction have not included in the countertrade agreement definite terms of the contract to be concluded (see chapter IV, "Countertrade commitment", paragraph 39). In a further example, the exporter may refuse to take delivery of the countertrade goods if the tendered goods do not conform to the agreed standards of quality. In order to avoid the possibility that the insured payment claim might be brought into question in such a situation, the insurer will usually require that steps be taken to make that payment claim independent from any disagreement concerning conclusion or performance of the contract in the other direction. Such independence can be established by using the separate-contract approach and by including in the countertrade agreement specific provisions indicating the independence of obligations (for a discussion on how the parties may wish to deal in the countertrade agreement with the relationship between their obligations, see chapter XIII, "Failure to complete countertrade transaction", paragraphs ___to___).

52. In the case of a barter contract, the party who is deliver goods first is subject to the risk that the other party will fail to deliver its goods in return (see above, paragraphs 6 and 7). Some private insurers and, in some cases, governmental insurance agencies may be prepared to insure that risk. The case covered by such insurance would usually be limited to the bankruptcy of the party who failed to deliver and to certain political risks such as governmental restrictions or prohibitions that prevent the fulfilment of the contract. Insurance cover may be easier to obtain if the other party provides sufficient security for its obligation to deliver goods. Such security may be provided in the form of an independent bank guarantee. Another possible

security may be an agreement giving the party who has delivered goods a right to take possession of the goods to be delivered in the other direction (see above, paragraph 49).

53. Parties often require financing in order to be able to carry out the transaction. The ability of a party to insure its credit risk is an important factor in the consideration by the financial institution whether to grant the requested financing. Financing may be in the form of a supplier credit or a buyer credit.

54. In the case of a supplier credit, the exporter delivers goods to the importer under a deferred payment arrangement and, in order to enable the exporter to enter into such an arrangement, a bank in the exporter's country provides financing to the exporter. Such financing may be, for example, in the form of a loan to the exporter or in the form of an undertaking by the bank that the bank will purchase the bills of exchange or promissory notes signed by the buyer in favour of the exporter. By purchasing the bills or notes, the bank, as the endorsee, would become the creditor of the foreign buyer. If no discounting of bills or notes takes place, the bank may require the exporter to assign the payment claim under the export contract to the bank. In addition, the bank may require the exporter to assign to it the benefits of the credit insurance policy. Such an assignment is often combined with an undertaking by the insurer to the effect that, if the buyer fails to pay under the export contract, and the failure falls within the risks covered by the insurance policy, the insurer will reimburse the bank. By becoming the beneficiary of the insurance policy, the bank is exposed to the risk that the exporter would breach the export contract and as a result the buyer would justifiedly fail to pay under the export contract. In such a case the bank would have recourse only to the exporter. The bank is also exposed to the risk that the reason for the buyer's failure constitutes a risk that is not covered by the insurance policy. In order to ameliorate the position of the bank, and in order to make it easier for exporters to obtain financing, some export credit insurers might be prepared, against a fee payable by the exporter, to issue to the bank providing financing to the exporter an unconditional guarantee supporting the bank's repayment claim against the exporter.

55. Under a buyer credit, the exporter arranges for a bank in the exporter's country to provide financing to the importer for the purchase of goods from the exporter. The bank in the exporter's country typically provides financing to a bank in the importer's country, which in turn extends financing to the importer. The bank in the exporter's country receives from the export credit insurer an undertaking whereby the insurer agrees to reimburse the bank if the buyer or its bank fail to repay the credit. Such an undertaking is issued on the application of the exporter and against payment by the exporter of an agreed premium. In case of failure by the buyer or its bank to repay the credit, the insurer who has reimbursed the bank that gave the credit has recourse to the exporter only if the exporter has failed to perform the obligations under the contract for the export of goods.

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INTERNATIONAL COUNTERTRADE

Draft Legal Guide on International Countertrade Transactions

Report of the Secretary-General

Addendum

IV. COUNTERTRADE COMMITMENT

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[Editorial note: The present draft chapter IV incorporates revised draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in A/CN.9/332/Add.8, revised paragraphs 26 and 27 from draft chapter V, "Type, quality and quantity of goods" as it appeared in A/CN.9/332/Add.4, and revised section C of draft chapter III, "Contracting approach", as it appeared in A/CN.9/332/Add.2. The revisions of paragraphs are underlined. The note in square brackets at the beginning of some paragraphs indicates that those paragraphs are new. An asterisk indicates the place where text has been deleted without adding new language.]

A. General remarks

1. [new paragraph] A countertrade commitment, a commitment to conclude a future contract, is an essential feature present in two types of countertrade transactions. The first type is when the parties at the outset of the transaction finalize a contract in one direction (export contract) and then commit themselves to conclude a counter-export contract (see chapter III, paragraphs 13 to 19); the second type is when the parties commit themselves at the outset of the transaction to conclude a series of supply contracts in the two directions (see chapter III, paragraphs 20 and 21). The term countertrade commitment is explained in chapter II, paragraph 25.

2. [new paragraph] The degree to which parties may commit themselves to enter into a future contract may range from a "firm" commitment to enter into a supply contract to a more limited "serious intention" type of commitment (referred to also as "best efforts" or "good faith" commitments). Under a firm countertrade commitment, the parties undertake to conclude a contract in accordance with the terms set out in the countertrade agreement, without retaining a discretionary right to refuse to conclude a contract. Under a serious-intention type of commitment, the undertaking is limited to an obligation to negotiate in good faith, with a party retaining the right to refuse to enter into a contract if none of the contract offers is acceptable to it. Under the latter commitment, any sanctions for failing to comply with the commitment can apply only in the limited cases when the party fails to participate in negotiations or does not negotiate in good faith. The Legal Guide focuses on firm countertrade commitments. It does not deal with serious-intention type of commitments since such commitments do not provide sufficient assurance to the parties that the objectives of the countertrade transaction will be achieved.

B. Extent of countertrade commitment

3. [new paragraph] The extent of a countertrade commitment is frequently expressed in a monetary value. In counter-purchase, buy-back or indirect offset transactions, in which the parties conclude first a supply contract in one direction (export contract) (see chapter III, paragraphs ...), the extent of the countertrade commitment is often expressed as a percentage of the value of the goods delivered under the export contract. In countertrade transactions in which the parties conclude the countertrade agreement prior to concluding an unspecified number of contracts in the two directions (see chapter III, paragraphs 20 and 21), the extent of the purchases to be made in

the two directions is often defined by an absolute monetary amount. Sometimes, however, the countertrade commitment is quantified by reference to a specific quantity of a given type of goods. It should be noted that the extent of the countertrade commitment may be subject to governmental regulations.

4. [new paragraph] In countertrade transactions with successive deliveries (e.g., buy-back transactions), in long-term transactions, or in transactions where the counter-exporter's financing costs are uncertain at the time of the conclusion of the countertrade agreement (e.g., because of a floating-rate credit arrangement), clauses are sometimes found providing for an increase or a decrease of the countertrade commitment depending upon movement in prices of the goods in question or in financing costs. In the case of capital goods, it may be agreed that the commitment will be increased in proportion to expenses for spare parts or technical assistance.

5. [from A/CN.9/332/Add.4, para. 26] When the purchaser has made prior purchases from the supplier of a given type of goods, the provisions in the countertrade agreement regarding quantity may contain a concept often referred to as "additionality". According to this concept, only those purchases that exceed the usual quantities purchased will be considered as fulfilling the countertrade commitment. The parties would normally be able to establish the threshold of additionality by agreeing on the quantity that is to be regarded as the usual or traditional purchase. When the parties do not identify the type of goods in the countertrade agreement, they may include a general stipulation that if the goods ultimately selected are of a type that the purchaser is already buying, only those purchases above existing levels would be counted toward fulfilment of the countertrade commitment.

6. [from A/CN.9/332/Add.4, para. 27] Where the arrangement allows the purchaser to choose from a number of eligible suppliers other than the party to whom the countertrade commitment is owed (e.g., in an indirect offset transaction), the additionality threshold would not be based on previous trade volume between the parties to the countertrade agreement, but on the trade volume with the suppliers selected or on the volume of previous purchases by the committed party in the suppliers' country. In defining the additionality threshold, the parties may, for example, agree on an amount of purchases that is to be considered as the usual or traditional amount of purchases, which would not be counted towards fulfilment of the countertrade commitment. The parties may also stipulate that purchases from specified types of suppliers or from certain specified suppliers, or purchases from those suppliers that do not exceed an agreed amount, are to be regarded as the usual or traditional purchases. In some cases, the parties may wish to apply an additionality threshold only to certain types of goods. The parties may provide in the countertrade agreement that the party committed to purchase can count its purchases toward the fulfilment of the countertrade commitment after it has been established in an agreed manner that purchases agreed to be regarded as usual or traditional have been made.

C. Time period for fulfilment of countertrade commitment

[The present section C incorporates, with underlined modifications, paragraphs 17 to 30 of draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in document A/CN.9/332/Add.8.]

1. Length of fulfilment period

7. The parties should specify in the countertrade agreement the length of time to be allowed for fulfilment of the countertrade commitment (hereinafter referred to as the "fulfilment period"). The countertrade agreement may determine the length of the fulfilment period by stipulating that the fulfilment period is to commence upon a fixed date and to expire on a fixed date.

8. Another method is to make the commencement of the fulfilment period contingent upon an event specified in the countertrade agreement and to set the length of the fulfilment period. Such an approach may be desirable in a variety of circumstances. For example, when the conclusion of the countertrade agreement precedes the entry into force of the export contract, the parties may agree that the fulfilment period will not begin until the export contract has entered into force. When there is uncertainty at the time of the conclusion of the countertrade agreement about the availability of countertrade goods or about the ability of the purchaser to utilize or market them, the parties may agree that the fulfilment period will commence upon the completion of certain preparatory activities (e.g., identification of goods, inspection by purchaser, certification of the technical capability of the factory producing the goods, agreement with a third-party purchaser or completion of joint marketing research). Where the exporter wishes to ensure that performance of the export contract is at an advanced stage or completed before performance of the countertrade commitment commences, the parties may stipulate in the countertrade agreement that commencement of the fulfilment period is to be triggered by an event in the performance of the export contract such as the opening of the letter of credit, delivery of a specified portion of the goods or payment. In a buy-back transaction, an appropriate moment might be the beginning of production of buy-back products by the facility supplied under the export contract. In order to avoid uncertainty as to whether the conditions for commencement of the fulfilment period have been met, it is advisable that the countertrade agreement state those conditions and the related obligations of the parties as precisely as possible.

9. In determining the length of the fulfilment period the parties should consider a number of factors. One factor is the size and type of the transaction being contemplated. For example, where the countertrade commitment is large and involves a series of shipments, more time would normally be needed for fulfilment of the countertrade commitment than if the transaction were relatively small. Where the countertrade agreement defines the countertrade goods in broad terms, it may be that a longer fulfilment period would be needed in order to allow time for identifying suitable countertrade goods. The quality of the countertrade goods may affect the length of the fulfilment period. The better the quality, the more likely it will be that the purchaser will either be able to market or use them in-house, thus allowing a shorter fulfilment period.

10. In some cases, the length of the fulfilment period is set so that it extends beyond the date when payment is due under the export contract. Such an approach would allow the exporter time to fulfil the countertrade commitment after payment under the export contract is due. In such a case it is in the interest of the importer to include in the countertrade agreement effective sanctions for breach of the countertrade commitment.

11. The parties may agree that the fulfilment period for the shipment in one direction is to be of the same length as the fulfilment period for the shipment in the other direction. Such an approach may be appropriate when no particular importance is attached to the order of the shipments in the two directions (e.g., countertrade carried out within the framework of a setoff account (chapter IX, "Payment", paragraphs ____) or an evidence account (paragraphs 68 to 74 below)). Such an approach may also be appropriate in a counter-purchase transaction in which the counter-importer is prepared to begin fulfilling the countertrade commitment without waiting to be paid under the export contract.

12. The fulfilment period should be of a sufficient length to take into account difficulties the supplier may encounter in making the countertrade goods available. If the goods are not made available in time, the purchaser could object to the exercise by the supplier of remedies for non-fulfilment of the countertrade commitment by claiming that non-fulfilment was due to unavailability of the goods. If the purchaser is entitled to select the goods from a list of eligible countertrade goods, the length of time needed to make available each of the different goods listed should be taken into account calculating the length of the fulfilment period.

2. Extension of fulfilment period

13. The parties may require more time to fulfil the countertrade commitment than provided by the countertrade agreement. For example, a purchaser may encounter unanticipated difficulties in utilizing or reselling the goods to be purchased. A supplier may have difficulties in making agreed upon goods available on schedule.

14. The law applicable to the countertrade agreement may provide for an extension of the time allowed for the performance of a party's contractual obligations in the event that the possibility of performance is affected by circumstances beyond the control of that party. The parties may wish to include in the countertrade agreement clauses addressing such situations (see chapter XIII, paragraphs ___, for a discussion of exemption * clauses).

15. The countertrade agreement may provide that the parties will negotiate an extension if the party seeking an extension has made reasonable efforts to fulfil the commitment. Alternatively, the parties might agree that, if the party made reasonable efforts to fulfil the commitment, that party would be entitled to an appropriate extension of the fulfilment period. It may be left to the parties to agree on the new fulfilment period. The countertrade agreement might indicate how the purchaser could demonstrate reasonable efforts. For example, in an indirect offset, it may be provided that the purchaser would have to show that it had made reasonable offers to potential suppliers to purchase goods, or that it had contacted a reasonable number of potential suppliers in search of suitable countertrade goods, or that potential suppliers had indicated that they would be willing to enter into

supply contracts some time after the expiry of the fulfilment period. Evidence of such reasonable, but unsuccessful, efforts are sometimes in practice referred to as "negative files". The countertrade agreement may also provide that a supplier who was unable to make goods available due to circumstances specified in the countertrade agreement would be entitled to an extension. Such circumstances may include, for example, lateness of the purchaser's order or changes in the purchaser's specifications. The parties may agree that a party could request an extension of the fulfilment period only if that party had fulfilled a portion of the countertrade commitment.

16. If the fulfilment of the countertrade commitment is supported by a guarantee, it is advisable that the parties provide that the period of the guarantee should be extended to cover an extension of the fulfilment period (see chapter XII, "Security for performance", paragraphs ____).

3. Subperiods within fulfilment period

17. Where fulfilment of the countertrade commitment involves many shipments over a long period of time, the parties may wish to divide the fulfilment period into subperiods. For example, a five-year fulfilment period could be divided into five annual subperiods, with a specified portion of the total commitment to be fulfilled during each subperiod. Such an approach assists the parties in planning delivery and marketing of the countertrade goods, and helps to ensure that fulfilment does not fall so far behind that the parties would be unable at the latter stages of the fulfilment period to fulfil the outstanding countertrade commitment.

18. The countertrade agreement may allow flexibility in dealing with shortfalls in the fulfilment of the commitment assigned to individual subperiods by permitting the carry-over of all or a portion of a shortfall to the next subperiod. In such a case, the purchaser would have, in the following subperiod, to fulfil the portion of the commitment allocated to that subperiod, as well as to fulfil the portion of the commitment carried over from the preceding period. The portion not carried over would be subject to sanctions for failure to fulfil the countertrade commitment (see chapters XI, "Liquidated damages and penalties", and XII, "Security for performance"). Such flexibility would allow the purchaser to adjust the quantity to be purchased in a given subperiod in response to circumstances such as short term market fluctuations. However, a high degree of flexibility might adversely affect the interests of the supplier if the proceeds of sales in each subperiod are to be used for payments under the supply contract in the other direction.

19. To address the possibility that the fulfilment achieved in a given subperiod exceeds the required level, the parties may agree that some or all of the extra purchases would be credited to the commitment due in the following subperiod. Alternatively, the parties may agree that the excess fulfilment in one subperiod would not affect the level of the commitment due in the following subperiod.

20. The parties may wish to set deadlines within the fulfilment period for completion of different actions that precede fulfilment of the countertrade commitment. For example, the parties could stipulate deadlines for providing samples of countertrade goods, selecting goods from a list of possible countertrade goods, placing orders, shipping goods or opening letters of credit.

D. Defining eligible supply contracts

[The present section D incorporates, with the addition of two new paragraphs, paragraphs 2 to 9 of draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in A/CN.9/332/Add.8.]

21. The parties normally define the supply contracts that will be counted towards fulfilment of the countertrade commitment ("eligible supply contracts") by indicating in the countertrade agreement the type of goods to be purchased under those future supply contracts. In some cases, the parties include in the countertrade agreement additional criteria relating to the geographical origin of the goods, the identity of the supplier, or the identity of the purchaser. When the parties are not in a position to indicate the type of goods in the countertrade agreement, some of these criteria may be included for the purpose of defining eligible supply contracts.

1. By type of goods

22. When the parties define the contracts eligible to be counted towards fulfilment by indicating the type of goods to be purchased, it is advisable that they do so with as much precision as possible. Precision is particularly advisable when the goods to be purchased exist in different varieties. (For a discussion of clauses in the countertrade agreement concerning the type of goods, see chapter V, "Type, quality and quantity of goods", paragraphs *3 to 23.*)

23. Sometimes the parties provide in the countertrade agreement that, in addition to the purchase of the countertrade goods, other related items are to be counted towards fulfilment of the countertrade commitment. Such ancillary items may be, for example, purchase of samples and prototypes in the course of selecting the countertrade goods, local contracting of labor, local purchase of goods and services essential for carrying out a supply contract, unbilled activities by the purchaser in the supplier's country (e.g., recruitment of personnel, training programs, secondment of staff and other forms of technical assistance), purchase from the supplier of transportation services, or performance by the purchaser of after-sales service on the countertrade goods. The countertrade agreement may provide that only a limited portion of the countertrade commitment may be fulfilled through such items.

24. When the purchaser has made prior purchases from the supplier, the countertrade agreement may provide that supply contracts must meet an "additionality" requirement in order to be counted toward fulfilment (see *above, paragraphs 5 and 6*).

25. [*new paragraph*] It should be noted that stipulations on eligibility of supply contracts based on the geographical origin of goods might conflict with mandatory rules of competition law and rules adopted pursuant to the General Agreement on Tariffs and Trade (GATT).

2. By geographical origin

26. Eligibility of supply contracts may be defined by a stipulation that countertrade goods must be produced in a particular geographical area. Stipulations of this type are sometimes found in indirect offset transactions where the importer wishes to channel the counter-purchases to a particular

region. Furthermore, the countertrade agreement may stipulate a required minimum level of local content. Such stipulations may provide that particular components of the goods must be locally produced or that the value of local components must constitute a certain percentage of the total value. Local content requirements are sometimes found in governmental regulations.

27. [new paragraph] As in the case referred to above in paragraph 25, stipulations requiring a party to purchase goods from identified suppliers might conflict with mandatory rules of competition law and provisions adopted pursuant to the General Agreement on Tariffs and Trade (GATT).

3. By identity of supplier

28. The parties may agree that the exporter is to fulfil the countertrade commitment by purchasing goods from persons other than the importer. This is typically the case in indirect offset (see chapter II, paragraph 17). In such cases, it is advisable that eligible supply contracts be defined by identifying the suppliers from whom the goods are to be purchased. The countertrade agreement may list eligible suppliers or may stipulate criteria to be observed by the purchaser in selecting a supplier. It may be provided, for example, that a selected supplier must be from a particular economic sector, be of a certain size, have a particular production programme, be located in a particular region, or be locally owned. Where several eligible suppliers are identified, the purchaser may be left free to distribute purchases among various suppliers or a particular structure of purchases from the identified suppliers may be stipulated. The identification of eligible suppliers does not necessarily mean that those suppliers have made a commitment to make countertrade goods available. In some cases the importer may provide an assurance that the eligible suppliers are prepared to negotiate the conclusion of a supply contract or the importer may promise to assist the purchaser in identifying a supplier who is willing to conclude a supply contract. (For a discussion of the participation of third persons as suppliers, see chapter VIII, paragraph .) The countertrade agreement may indicate the effect on the countertrade commitment if none of the eligible suppliers are prepared to conclude a supply contract.

4. By identity of purchaser

29. A restrictive element sometimes found in the definition of eligible supply contracts concerns the identity of the purchaser. For example, the countertrade agreement may provide that only purchases made by the party committed to purchase goods or by specified third persons (e.g., third persons from a particular country or geographical region) are to be counted toward fulfilment. For a discussion of restrictions on the participation of third persons as purchasers, see chapter VIII, paragraph .

5. Non-conforming purchases

30. The parties may agree that under certain circumstances purchases that do not conform to the eligibility requirements in the countertrade agreement would nevertheless be counted toward fulfilment of the countertrade commitment. For example, non-conforming purchases could be counted if the good faith efforts of the purchaser to locate suitable goods from the eligible suppliers or in the geographical regions or economic sectors identified in the countertrade agreement were unsuccessful. A provision of that type could call

upon the purchaser to provide evidence of efforts to make purchases of the type required by the countertrade agreement (for a discussion of the analogous case of a party requesting an extension of the fulfilment period, see above, paragraphs 13 to 16). It could be agreed that the specific prior consent of the party to whom the commitment is owed would be necessary for the purchases not meeting the eligibility requirements to be counted toward fulfilment. In order to foster efforts to comply with origin requirements, the countertrade agreement could limit the availability of an exception to the later stages of the fulfilment period. Furthermore, the parties may agree that purchases counted toward fulfilment that fall outside the eligibility provisions are to be counted at less than the full value of the purchases (see paragraphs 32 and 33 below).

E. Rate of fulfilment credit [change of title]

[The present section E incorporates, with underlined modifications, paragraphs 13 to 16 of draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in A/CN.9/332/Add.8.]

31. In many countertrade transactions, the full purchase price of a supply contract is deducted from the outstanding countertrade commitment (the amount deducted from the outstanding countertrade commitment is hereinafter referred to as "fulfilment credit"). Sometimes the parties agree that the fulfilment credit granted for a supply contract is to be an amount different from the purchase price. One reason for such an approach may be that the parties wish to give fulfilment credit for certain outlays not included in the cost of the goods themselves (e.g., transportation and insurance) or to exclude from the fulfilment credit certain costs included in the purchase price. The supplier may agree to the crediting of such cost elements if, for example, they involve the purchase in the supplier's country of services related to the performance of the supply contract. The rate of fulfilment credit might also be prescribed by mandatory provisions of law (chapter XIV, "Choice of law", paragraphs).

32. The countertrade agreement may provide that purchases are to be credited toward fulfilment of the countertrade commitment at different rates depending upon the type of goods purchased. For example, fulfilment credit could be granted at the rate of 50 percent of the purchase value for one type of goods and 150 percent for another, or that investments or technology transfer will be credited at more than the capital contribution of the investment or the monetary value of the technology transfer (e.g., 150 percent). Such a variable rate of fulfilment credit may be used in particular in indirect offset transactions, in which the exporter concludes contracts with third parties, and the importer wishes to promote the purchase of certain types of goods. * In direct offset, as well as in buy-back, the countertrade agreement may provide that a certain amount of fulfilment credit will be granted for export sales, other than those to the counter-importer, generated by the production facility supplied by the exporter. Credit may also be granted for a percentage of the value of sales to buyers in the counter-exporter's country. A variable rate of fulfilment credit might also be used in transactions in which the supply contracts are to be entered into between the parties to the countertrade agreement, in particular if the purchaser has a choice between several types of goods; in such a case the variable rate may serve as a stimulus to purchase a certain type of goods.

33. The countertrade agreement may also provide for different rates of fulfilment credit depending upon the identity of the supplier, the geographical origin of the goods or the identity of the purchaser. The rationale behind such a provision is to steer the activities of the purchaser towards particular suppliers or regions, or to introduce the goods in certain markets.

34. The rate of fulfilment credit may also be made to vary according to the point of time when a purchase is made. Under a scheme of this type, the purchaser could fulfil the countertrade commitment by the purchase of a smaller quantity of goods if a supply contract was concluded at an early stage of the period for the fulfilment of the countertrade commitment. This approach is designed to give the purchaser an incentive for fulfilling the commitment earlier rather than later in the fulfilment period. In such a case it is particularly important that the countertrade agreement specify the point when fulfilment credit is to be given (e.g., when an order is placed or when payment is made).

F. Stage when commitment fulfilled

[The present section F incorporates, with underlined modifications, paragraphs 10 to 12 of draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in A/CN.9/332/Add.8.]

35. It is advisable that the countertrade agreement indicate the specific action that must be taken in order for the countertrade commitment to be fulfilled. The parties may choose between two basic approaches. Under one approach, the countertrade commitment is deemed to be fulfilled once a supply contract is concluded. In such cases, a breach of an obligation under the supply contract would be subject to remedies available under the supply contract. The parties may agree that, if the supply contract is not performed due to a reason imputable to one party, the amount of the unperformed contract could, at the option of the other party, be reinstated in the countertrade commitment.

36. Under the second approach, the commitment is deemed to be fulfilled at an agreed stage in the performance of the supply contract. For example, it may be agreed that the commitment of the purchaser is fulfilled when the letter of credit is opened or when the funds have been transferred to the supplier and that the corresponding commitment of the supplier is fulfilled when the goods are delivered or placed at the disposal of the purchaser in the agreed manner. In such cases, in the event of a breach of the supply contract, the aggrieved party might be able to invoke remedies not only for breach of the supply contract, but also for breach of the countertrade agreement if the countertrade commitment remained unfulfilled. A disadvantage of this second approach is that it is more complicated and uncertain than the first approach, under which fulfilment is deemed achieved simply upon the conclusion of a supply contract. The second approach might result in uncertainty when exempting impediments affect the ability of a party to take the steps necessary in the performance of a supply contract to achieve fulfilment of the countertrade commitment. In order to avoid this uncertainty, additional provisions would be required in the countertrade agreement on the effect of such impediments.

37. The parties may wish to address the effect on the countertrade commitment of a failure to conclude or perform a supply contract. It may be agreed, for example, that when the reason for such a failure is imputable to one of the parties, the outstanding countertrade commitment of the other party may, at the option of that other party, be deemed fulfilled in the amount of the unaccepted contract offer or unperformed contract (see chapter XIII, "*Failure to complete countertrade transaction*", paragraph).

G. *Defining terms of future supply contracts*

[*The present section G is a restructured section C, paragraphs 37 to 61, of draft chapter III, "Contracting approach" as it appeared in A/CN.9/332/Add.2. Paragraps 39 to 42 of the earlier section C, A/CN.9/332/Add.2, entitled "Negotiation procedures", have been included at the end of the present subsection 6.*]

1. *Terms of future supply contracts*

38. [*paragraph 43 in A/CN.9/332/Add.2*] Commitments to enter into supply contracts often do not stipulate in a definite manner *all* the terms of the contracts to be concluded. *Sometimes* the parties *have not decided yet on* the type of goods that will be the subject of the future supply contracts or what the terms of delivery will be. Even if the parties *are* able to set out in the countertrade agreement terms of the future supply contract, they sometimes forego doing so because they expect each party to live up to the commitment to conclude a future contract, though the terms of that contract may not be defined in great detail in the countertrade agreement.

39. [*new paragraph*] A lack of definiteness of the countertrade commitment may result in delays or uncertainties in negotiating a supply contract in view of the potentially broad scope of the negotiations. It is therefore advisable that the parties, to the extent feasible, include in the countertrade agreement the terms of the future contract or provide for means for subsequent determination of those terms (see paragraphs 44 to 56 below). In addition, the parties may wish to address in the countertrade agreement procedures to be followed in their negotiations (see paragraphs 57 to 60 below). This will facilitate negotiations, increase the likelihood that a supply contract will be concluded and increase the possibility that the party interested in the conclusion of the contract would be able to hold the other party responsible for refusing to conclude the contract. If, for example, the countertrade agreement specifies the goods that a party is committed to purchase, or at least contains a list of goods as a basis of negotiations, the counter-exporter may be able to show that the refusal of the counter-importer to purchase any goods constitutes a breach of the countertrade commmitment. If the goods are specified, it is also advisable to provide a mechanism for determining the price; this is particularly important when the countertrade goods are not of a standard type and it may be open to disagreement what is a fair market price.

40. [*paragraph 46 in A/CN.9/332/Add.2*] As the countertrade agreement becomes more definite *in specifying* the terms essential for the existence of an enforceable contract, the agreement approaches the point at which the parties have settled all the terms of the supply contract and postponed only the act of *concluding* the contract. *When the countertrade agreement embodies the essential terms of the future contract for the purchase of goods, in some*

legal systems the possibility exists that such a countertrade agreement could be relied upon as an enforceable sales contract. In order to avoid disagreements, it is advisable that the parties, when concluding a countertrade agreement that contains the essential terms of the contract to be concluded, stipulate clearly whether a separate contract is to be executed pursuant to the countertrade agreement.

41. [paragraph 47 in A/CN.9/332/Add.2] Many legal systems contain rules to which the parties may resort in order to provide definiteness to a contract clause. For example, numerous legal systems provide a solution when the parties have not settled the price of the goods; the solution may be, for instance, that the price should be the one "generally charged at the time of the conclusion of the contract for such goods sold under comparable circumstances in the trade concerned" (article 55 of the United Nations Convention on Contracts for the International Sale of Goods). Another example may be the rule on the quality of the goods to be delivered under the contract when the contract has not settled that issue; the rule in article 35(2)(a) of the above-mentioned Convention is that the goods should be "fit for the purposes for which goods of the same description would ordinarily be used". In some legal systems the parties may, within certain limits, resort to a court for the purpose of determining such a contract element. In other legal systems, however, the courts are not competent to intervene in this manner in a contractual relationship.

42. [paragraph 48 in A/CN.9/332/Add.2] Although such means for contract supplementation exist in many legal systems, they normally do not provide a solution in all cases of indefiniteness. The contract elements left indefinite in the countertrade agreement may not lend themselves to being made definite by reference to the applicable law. For example, if the parties have not agreed on the type of goods to be counter-exported, it would probably be impossible to determine the type on the basis of the applicable law. Where the type of goods has been settled, the criteria provided in the applicable law concerning the price of the goods may not lead to a clear solution. Furthermore, such contract supplementation is subject to uncertainty arising out of divergencies among legal systems as to the techniques of supplementation, the role of the courts or arbitral tribunals in determining the missing term, the role of the parties, or as to the judicial control over the result of the supplementation. * As a result, the parties may wish to consider the contractual means discussed below for providing definiteness to a contract term left open in the countertrade agreement.

43. [paragraph 49 in A/CN.9/332/Add.2] The terms that are often left indefinite in the countertrade agreement and with respect to which contractual means for completing indefinite terms may be particularly useful are the type, quality, price and quantity of the countertrade goods. The contractual means that the parties may consider for completing any one or more of those terms are discussed in a general manner in subsections (a) through (c) below. In other parts of the Legal Guide, these contractual means will be referred to in specific contexts.

(a) Standards or guidelines

44. [paragraph 50 in A/CN.9/332/Add.2] The parties may wish to provide standards or guidelines to be used in determining particular contract terms. The use of a standard would allow the parties to determine a contract term by

computation or by some other objective method not dependent upon the discretion of the parties. Examples of such standards include a formula, tariff, quotation, rate, index, statistic, or some other criterion not influenced by the will of either party. For example, the price of the countertrade goods may be determined by reference to the price at which goods of the same type are sold in a particular market or exchange, or the quality of the countertrade goods may be defined by reference to a particular national or international quality standard. Many legal systems recognize as valid a provision that the price or other contract term should be determined by reference to a standard.

45. [paragraphs 50 and 45 in A/CN.9/332/Add.2] Guidelines, on the other hand, set parameters within which a contract term is to be determined and involve a degree of latitude in arriving at a contract term. For example, the countertrade agreement may set a range within which the parties are to negotiate the price or it may be agreed that the price must be "reasonable" (such price clauses are further discussed in chapter VII, "Pricing of goods", paragraphs). [The following underlined text has been taken from from para. 45 of A/CN.9/332/Add.2:] Sometimes the parties are not in a position to be more definite about the terms of the anticipated supply contract than to provide that the contract terms should be fair or in accordance with the prevailing market conditions. Such provisions may be helpful when countertrade goods of a standard quality are agreed upon, thereby enabling a fair price to be ascertained. If, however, the type of countertrade goods is not settled or if the countertrade goods are products that do not have a standard price, such a "fair terms" commitment may not substantially enhance the position of the party interested in the conclusion of the contract. In such cases opinions may differ as to what contract terms are fair, thereby protracting the negotiations and making uncertain the success of a claim against the party refusing to conclude the contract. If the type of goods has not been determined, the parties may agree on a list of goods on which the negotiations should focus or to which it should be limited (such lists are discussed in chapter V, "Type, quality and quantity of goods"). As to other terms of the future contract, such as delivery, the parties may agree that the supply contract should be negotiated on the basis of prevailing market conditions. Where reference is made to market conditions, it is advisable that the parties refer to a specific market.

46. [paragraph 52 in A/CN.9/332/Add.2] Because of the discretion left to the parties, the inclusion of a guideline in the countertrade agreement for a particular term in the future contract does not ensure the finalization of that term. Nevertheless, a narrow range within which agreement should have been achieved, or clear guidelines limiting the latitude available to the negotiators, will not only make it more likely that a contract will be concluded but will also make it easier to show that a party refusing a given contract offer is in breach of the countertrade commitment.

(b) Determination of contract term by third person

47. [paragraph 53 in A/CN.9/332/Add.2] Sometimes the parties agree that a particular contract term will be determined by a third person. While such an approach provides a high degree of certainty that the term will be made definite, its infrequent use may be attributable to a reluctance by parties to relinquish their control over a contract term. When such a method is used, it is usually to determine the price of goods (see chapter VII, paragraphs and

___). The parties might be willing to agree on such a method of determining a contract term if clear, and preferably narrow, guidelines are established within which the third person is to decide or if the third-person intervention is the last resort after other agreed mechanisms (e.g., negotiation, application of an agreed standard) have failed. If the parties do not wish to entrust the decision on a contract term to a third person, but still want the benefit of the opinion of a third person, it may be agreed that the determination by the third person will only be a recommendation.

48. [paragraph 54 in A/CN.9/332/Add.2] A number of legal systems recognize the right of the parties to entrust a third person with determining a contract term. In particular, reference by the parties to a third person for the determination of the price is a question frequently addressed in legal systems. There are, however, variations among the systems. For example, while some legal systems recognize that an arbitral tribunal or even a court may be entrusted with the determination of a contract term, others permit such a determination only if it is not performed as part of arbitral or judicial proceedings. Legal systems also differ as to the consequences of a failure by the parties to agree on the third person or of a failure by the third person to act. Under some legal systems, the parties would have no recourse to a procedure for designating or replacing the person, and would have to accept the consequences of the contract term being left undetermined. In other systems, if the third person was to determine the price, the case may be treated as if the parties had agreed on a reasonable price. There are also differing approaches to the availability and extent of judicial review of a decision by a third person.

49. [paragraph 55 in A/CN.9/332/Add.2] The issues that the parties may wish to address in a stipulation empowering a third person to determine a contract term are discussed in the following paragraphs.

50. [paragraph 56 in A/CN.9/332/Add.2] Person to request determination of term. The parties may wish to address the question whether, at the time when the parties fail to agree on the term, either party would be entitled to request the third person to determine the term or whether the third person may act only upon the request of both parties.

51. [paragraph 57 in A/CN.9/332/Add.2] The identity of the third person or the appointment procedure. The parties may wish to name in the countertrade agreement the person who is to determine the contract term. In this case, the parties may also wish to provide an appointment procedure to be used in the event that the named person fails to act or is unable to act. If the parties do not wish to name the person who is to determine the contract term, it may be advisable for the parties to agree that they will appoint the third person at such time as they are unable themselves to reach agreement on the contract term. In such a case the parties may wish to agree on an appointment procedure, which is to become operative if the parties cannot reach agreement on the appointment of the third person.

52. [paragraph 58 in A/CN.9/332/Add.2] Guidelines or standards to be observed by third person. The parties are advised to delimit the mandate of the third person by providing guidelines or standards to be observed in determining the contract term. Such guidelines and standards are discussed generally above, paragraphs 50 to 52, and, as to price, in chapter VII, "Pricing of goods", paragraphs ___ to ___.

53. [paragraph 59 in A/CN.9/332/Add.2] Nature of decision of third person. The parties may agree that the decision by the third person would be binding as a contractual stipulation of the parties. Another approach may be to provide that the determination of the third person would be treated as a recommendation to be considered by the parties in good faith.

54. [paragraph 60 in A/CN.9/332/Add.2] Procedure for challenging decision by the third person. In some situations, for example, where the binding determination by the third person involves a question of particular economic significance, the parties might wish to provide an opportunity for the decision to be challenged by resort to another person, a panel of persons, or an institution. As to the nature of the decision on the challenge, it may be provided that the decision would bind the parties or only be a recommendation. The parties may wish to stipulate the mandate that would be given to the person deciding on the challenge (i.e., to uphold or reject the challenge, or to modify the challenged decision). The parties may wish to indicate how, in the event the challenged decision is set aside, the decision on the contract term is to be made (e.g., by the parties themselves or by the same or a different third person).

(c) Determination of contract term by contract party

55. [paragraph 61 in A/CN.9/332/Add.2] Sometimes the countertrade agreement leaves the determination of a contract term to one of the parties to the countertrade agreement. Utmost caution is advisable in agreeing on such a solution, which leaves the determination of the contract term to a person who has an interest in the outcome of the determination.

56. [paragraph 61 in A/CN.9/332/Add.2] The parties should be aware that a clause empowering a contract party to determine a contract term is in many legal systems not enforceable. Where such a clause is recognized, it is subject to strict conditions. If the subject of the determination is the price, a number of systems would recognize such a right given to a party if its exercise is limited by such standards as reasonableness, good faith or fairness. Some of these systems would construe an agreement not expressly referring to such a standard as implicitly referring to it. Other legal systems require the freedom to determine the price to be limited by a more definite standard such as objectively ascertainable market prices, price averages or absolute limits stipulated by the parties. Analogous restrictions apply to the determination of terms such as the quantity of goods to be delivered under a contract or the time of contract performance.

2. Negotiation procedures

57. [paragraph 39 in A/CN.9/332/Add.2] Countertrade agreements may set forth with varying degrees of procedural detail the manner in which negotiations are to be carried out. Specifying the negotiation procedures increases the probability that the negotiations will lead to a successful outcome. This would be particularly true where the nature of the negotiations is likely to be complicated, either because of the subject matter of the eventual contracts or because of the number of persons who might be involved in those negotiations.

58. [new paragraph] Care should be taken to make negotiating procedures a part of a firm undertaking to conclude a supply contract. If the undertaking

is limited to a mere obligation to negotiate, the parties, as noted above in paragraph 2, will have little assurance that the objectives of the transaction will be achieved. Even if negotiating procedures are combined with a firm countertrade commitment, such procedures alone do not ensure that negotiations will be successful. The most effective way to increase the likelihood of succeeding in the negotiations would be either to stipulate in the countertrade agreement the terms of the future contract or, if this is not possible, to agree on means for providing definiteness to the countertrade commitment. Such means are discussed above, in particular in paragraphs 44 to 56.

59. [paragraph 40 in A/CN.9/332/Add.2] At a minimum, the countertrade agreement might provide that a party would be obligated to respond to contract proposals by the other party. More specific procedures would address issues such as: the party who is to submit a contract offer; questions to be covered by a contract offer; time periods for submitting it; the form, means or frequency of communication; the time period for reply; the time within which an agreement must be reached, and beyond which negotiations will be deemed to have failed. Furthermore, the parties may provide that in certain circumstances a party would be relieved of the duty to negotiate (e.g., when that party has made an offer meeting the agreed conditions and it has not been accepted, or, if the other party was to make the offer, when no such offer has been made).

60. [paragraph 41 in A/CN.9/332/Add.2] The stipulation of negotiation procedures such as those mentioned in the previous paragraph may * increase the possibility that a party who has not negotiated in good faith could be held responsible for the failure to conclude a contract. Such procedures could enable an aggrieved party to demonstrate, for example, that the other party refused to negotiate, imposed conditions to negotiate that the party could not properly impose, used unfair dilatory tactics, reopened discussion on issues already agreed upon, negotiated with other parties when it was improper to do so, or prematurely broke off negotiations.

H. Monitoring and recording fulfilment of countertrade commitment

[The present section H incorporates, with some underlined modifications, paragraphs 31 to 44 of draft chapter VII, "Fulfilment of countertrade commitment" as it appeared in A/CN.9/332/Add.8.]

61. The parties may wish to consider establishing procedures for monitoring and recording the progress made in fulfilment of the countertrade commitment. Such arrangements may be particularly useful in long term countertrade transactions with multiple shipments in one or both directions.

1. Exchange of information

62. The parties may wish to establish procedures for exchange of information on progress in the fulfilment of the countertrade commitment. Such procedures may be useful, in particular, in "indirect offset" transactions (chapter II, paragraph 17), since the countertrade commitment is owed to a person who does not act as the supplier of the countertrade goods and the potential suppliers are, therefore, not parties to the countertrade

agreement. A system of exchange of information may also be useful when the parties are engaged in a large volume of mutual trade, especially when only a part of that trade stems from the countertrade agreement.

63. The parties may include in the countertrade agreement guidelines concerning the contents, frequency and timing of the information to be exchanged. The required information could cover, for example, contracts that have been concluded and are eligible to be counted towards fulfilment (especially when concluded with a third person), shipments that have been made, payments effected in accordance with agreed upon procedures and purchases planned for an upcoming subperiod of the fulfilment period. Furthermore, the parties to the countertrade agreement sometimes find it useful to meet periodically to assess the progress that is being made towards fulfilment. Such meetings could be used to review the status of concluded contracts and those under negotiation and to consider possible modifications of the countertrade agreement. The countertrade agreement could address questions such as the frequency and location of meetings and the representation of the two sides.

64. In particularly complex transactions that require ongoing monitoring and coordination, the parties may wish to establish in the countertrade agreement a joint coordination committee. It is advisable that the parties address issues such as the frequency and location of meetings, representation of the two sides, the manner in which the results of the meetings will be reported and the mandate of the committee. The mandate of such a committee would typically be to assess progress in the implementation of the transaction, analyse difficulties and consider possible solutions, establish working groups for specific problems, and consider proposals to amend the countertrade agreement.

2. Confirmation of fulfilment of countertrade commitment

65. The parties may agree that the purchaser has a right to obtain from the party to whom the countertrade commitment is owed a written confirmation of the fulfilment of the countertrade commitment. Such a confirmation may take the form of a statement from the supplier (sometimes referred to as a "letter of release"). The parties may agree that the letter of release is a condition for payment under the supply contract concluded in fulfilment of the countertrade commitment (e.g., the letter of credit terms may specify that the letter of release is to be among the documents presented to the bank in order to obtain payment). Fulfilment of the countertrade commitment may also be evidenced by a clause in the supply contract stating that the contract is concluded in fulfilment of the countertrade commitment.

66. Written confirmation of fulfilment is intended to avoid disagreements, which may occur after a particular supply contract has been performed, as to whether the contract counts towards fulfilment of the countertrade commitment. Written confirmation may also be helpful to a party who wishes to demonstrate (e.g., in negotiating other countertrade agreements) a record of fulfilling countertrade commitments.

67. Where written confirmations are envisaged in a multiparty transaction (see chapter VIII, "Participation of third parties", paragraphs to), it is advisable that the countertrade agreement indicate whether the fulfilment

of the commitment is to be confirmed by the supplier of the goods or by the party to whom the commitment is owed. Absent such an indication, a disagreement may arise between the purchaser and the party to whom the commitment is owed as to the significance of a statement by a third-party supplier that a supply contract fulfils the countertrade commitment, or of a clause in a supply contract with a third-party supplier to that effect.

3. Evidence accounts

68. The parties may agree that the supply contracts in the two directions are to be recorded in a ledger kept by themselves, by a bank or by a controlling authority. Such a ledger is referred to herein as an "evidence account", a term frequently used in practice. Other terms used in practice include "record account" and "trade account". An evidence account is not a payment mechanism. Rather, it is used only for recording the conclusion, performance and value of supply contracts, with financing and payment being arranged independently. With an evidence account, the parties undertake a countertrade commitment of a given value and then conclude supply contracts in the two directions without having to negotiate a countertrade commitment for each individual supply contract. Evidence accounts may accommodate multiple parties on one or both sides. An evidence account may be particularly useful in a long-term countertrade transaction to monitor the cumulative value of the purchases in the two directions and thereby to assist the parties in dealing with imbalances that may develop.

69. The use of an evidence account may be subject to governmental regulations. Such regulations may determine the manner in which an evidence account is to operate and require administration of the account by a controlling authority such as the central bank or foreign trade bank. An evidence account administered by a controlling authority may provide the purchaser access to a wider variety of countertrade goods and trading partners than might be available without an evidence account administered by the controlling authority. Government regulations may also require authorization of evidence accounts. It may be provided that such authorization would be given only for countertrade transactions exceeding a minimum turnover and to parties with an established presence in a given country. In some cases, an evidence account is authorized with the restriction that purchases by third parties will not be counted towards fulfilment of the countertrade commitment; such a restriction may be imposed when the motive for permitting an evidence account is to establish a long term trading relationship with a particular party. The countertrade goods may be limited to those agreed upon by the parties or those that the controlling authority has an interest in promoting.

70. When the parties are free to establish an evidence account, they may decide to administer the account themselves or to engage a bank or banks to do so. A variety of structures are possible depending on whether the account is administered by one or both of the parties or by one or two banks engaged by the parties. For example, parallel accounts could be established by a party or a bank on each side of the transaction in which supplies are credited and purchases are debited. Each parallel account could in turn consist of two ledgers, one listing contracts concluded in each direction and the other recording payments. If banks are to administer the evidence account, the parties may wish to use the banks that handle payment for the supply contracts.

71. The countertrade agreement should specify the documentation required for triggering entries in the evidence account (e.g., copies of contracts, evidence of letters of credit, or shipping documents). Such documentary requirements should be in line with the provisions in the countertrade agreement concerning the stage when the countertrade commitment is deemed fulfilled (see above, paragraphs 35 to 37). In order to minimize administrative burden, the parties may wish to align to the degree possible the documentary requirements for the evidence account with those of any governmental authority monitoring the countertrade transaction.

72. It is advisable that the parties address in the countertrade agreement deviations from the agreed upon ratio between the values of the shipments to be made in the two directions. It may be agreed that, while the agreed upon ratio must be achieved upon the conclusion of the fulfilment period or at specified points in the fulfilment period, the values of the shipments may deviate from the agreed ratio during the fulfilment period or between the specified points in the fulfilment period. The parties may further agree that deviations during the fulfilment period must remain within a specified range. For example, during the fulfilment period the value of the shipments in one direction should be not less than 60 and not more than 120 per cent of the value of the shipments in the other direction. It may be agreed that, if a party fails to conclude the supply contracts necessary to achieve the agreed upon ratio, the other party is entitled to suspend conclusion of contracts, or to suspend shipment of goods, in the other direction until the ratio is achieved (see also chapter XIII, "Failure to complete countertrade transaction", paragraph). A failure to achieve the agreed ratio may also be made subject to sanctions (see chapters XI, "Liquidated damages and penalties", and XII, "Security for performance"). It is advisable to define in the countertrade agreement small deviations from the ratio that would be tolerated.

73. In order to minimize errors or discrepancies in the evidence account, it is advisable for the parties to agree to verify at fixed points of time the information entered in the account.

74. Where two banks are involved in administering the evidence account, the technical details of the account may be the subject of an interbank agreement. The countertrade parties have an interest in the contents of the interbank agreement, though they are not normally parties to it. It is therefore advisable that the parties consult with the banks to ensure that the evidence account established by the banks is acceptable to the parties.

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INTERNATIONAL COUNTERTRADE

Draft Legal Guide on International Countertrade Transactions

Report of the Secretary-General

Addendum

V. GENERAL REMARKS ON DRAFTING

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[Editorial note: The present draft chapter V is a revision of draft chapter IV bearing the same title and published as document A/CN.9/332/Add.3. Where the numbering of a paragraph has changed, the earlier paragraph number appears in square brackets at the beginning of the paragraph. The revisions of paragraphs that appeared in A/CN.9/332/Add.3 are underlined.]

A. General remarks

1. A countertrade transaction is usually the result of extensive written and oral communications between the parties. Each party may find it desirable to establish a checklist of the necessary steps to be taken in negotiating and drawing up contracts constituting the transaction (the countertrade agreement and the supply contracts). Such a checklist could reduce the possibility of omissions or errors occurring in the steps taken prior to entering into the contracts. A party may also wish to consider seeking legal or technical advice in drawing up the contracts. While countertrade transactions can be expected to become routine for parties experienced in countertrade, even simple countertrade transactions may pose difficulties for newcomers to countertrade calling for legal or technical advice. For complex transactions, even experienced parties may require advice.

2. The process of establishing a countertrade transaction could be facilitated if the parties agree that, before a first draft of the countertrade agreement and any supply contract is prepared, negotiations on the main technical and commercial issues are to take place. Thereafter, one of the parties could be asked to submit a first draft reflecting the agreement reached during the negotiations. A first draft may then be discussed and elaborated, resulting in a preliminary set of contract documents, which, after review and finalization, will govern the relationship between the parties.

3. The legal rules applicable to the countertrade agreement may require that a countertrade agreement be in written form. Even when written form is not required, it is recommended that the parties express their agreement in writing to avoid later disputes as to what terms were actually agreed upon. If the parties decide that modifications of the countertrade agreement are to be in writing, it is advisable that this be stated in the countertrade agreement. However, even if such a provision has been included in the countertrade agreement, there may be situations in which a modification can be made otherwise than in writing. A number of legal systems have rules, comparable to article 29(2) of the United Nations Sales Convention, according to which a party may be precluded by its conduct from asserting a contract provision that any modification or termination of the contract must be in writing to the extent that the other party has relied on that conduct.

4. It is desirable that the parties clarify the relationship between the contract documents, on the one hand, and the oral exchanges, correspondence and draft documents which came about during the negotiations, on the other. The parties may wish to provide that those communications and draft documents are not part of the contract. They may further provide that those communications and draft documents cannot be used to interpret the contract,

or, alternatively, that they may be used for this purpose to the extent permitted by the applicable law. Under the law applicable to the contract, oral exchanges, statements and conduct of a party and correspondence may be relevant to the interpretation of the contract even if they occur after the contract is entered into.

5. The parties should ensure that the contract terms as expressed in writing are unambiguous and will not give rise to disputes, and that the relationship between the various documents comprising the transaction is clearly established. Such precision may be of particular importance in countertrade transactions that are carried out over a long period and may have to be administered by persons who have not participated in the negotiations at the outset of the transaction (e.g. buy-back or offset transactions). Each party may find it useful to designate one person to be primarily responsible for supervising the preparation of the contract documents. It is advisable for that person to be a skilled draftsman familiar with international countertrade transactions. To the extent possible, it is advisable for that person to be present during important negotiations. Each party may find it useful to have the final contract documents scrutinized by a team having expertise in the subject-matter reflected in the documents in order to ensure accuracy and consistency of style and content.

6. The applicable legal rules may also contain rules on the interpretation of contracts and presumptions as to the meaning of certain expressions such as "reasonable price" (chapter VI, "Pricing of goods", paragraph 24), "trust" and "compte fiduciaire" (chapter IX, "Payment", paragraph 16), and "penalty" (chapter XI, "Liquidated damages and penalties", paragraph __). The parties are advised to select contract wording in light of the applicable law in order to ensure that the expressions used reflect the intended meaning. One approach is for the applicable law to be determined at a very early stage of the relationship between the parties (e.g., at the commencement of negotiations). The countertrade transaction may then be negotiated and drawn up taking that law into account. Another approach is for the parties to determine the applicable law only after negotiations have taken place on the main technical and commercial issues and have resulted in a measure of accord between the parties. They may thereafter review the first drafts relating to the transaction, which reflect that accord, in the light of the applicable law to ensure that the terms of the draft take account of that law. The advisability of stipulating the law applicable to the countertrade agreement and the related supply contracts is discussed in chapter XIV.

7. The parties should take into account the mandatory legal rules of an administrative, fiscal or other public nature in the country of each party that are relevant to the countertrade transaction. They should also take into account such mandatory legal rules in other countries when those rules are relevant to the transaction. Certain rules may concern the technical aspects of the countertrade agreement (e.g., safety standards for the countertrade goods or rules relating to environmental protection), and the terms of the countertrade agreement should not conflict with those rules. Other rules may concern export, import and foreign exchange restrictions (e.g., it may be provided that certain rights and obligations are not to arise until export or import licences, approvals for payments or for the use of particular payment mechanisms have been granted). Legal rules relating to taxation may be a factor, and the parties may wish to include in the countertrade agreement provisions dealing with liability for tax. Mandatory provisions are also considered in chapter XIV, "Choice of law", paragraphs ___ to ___.

8. The parties may wish to consider whether the countertrade agreement is to contain introductory recitals. The recitals may set forth representations made by one or both parties which induced the parties to enter into the agreement. The recitals may also set out commercial objectives to be achieved through the transaction or describe the context in which the countertrade agreement was entered into. The extent to which recitals are used in the interpretation of the terms of the agreement introduced by the recitals varies under different legal systems, and their impact on the interpretation may be uncertain. Accordingly, if the contents of recitals are intended to be significant in the interpretation or implementation of the countertrade agreement, it may be preferable to include those contents in the operative provisions of the countertrade agreement.

9. The parties may find it useful to examine standard forms of countertrade agreements, general conditions, standard clauses, or previously concluded countertrade agreements to facilitate the preparation of contract documents. Such an examination may clarify for the parties the issues that should be addressed in their negotiations. However, it is inadvisable to adopt provisions appearing in those documents without critical examination. Those provisions may, as a whole, reflect an undesirable balance of interests, or those provisions may not accurately reflect the terms agreed to by the parties. The parties may find it advisable to compare the approaches adopted in the forms, conditions or countertrade agreements examined by them with the approaches recommended in the present Legal Guide.

B. Language

10. The contracts constituting the countertrade transaction (i.e., the countertrade agreement and the individual supply contracts) may all be drawn up in only one language version (which may, but need not be, the language of either of the parties), or in the two languages of the parties where those languages differ, or the countertrade agreement may be drawn up in one language and the supply contracts in another language. Where the conclusion of the countertrade agreement precedes the conclusion of the supply contracts in the two directions (chapter III, "Contracting approach", paragraph 19), or where it precedes the conclusion of the counter-export contract (chapter III, paragraphs 12 to 18), it is advisable that the countertrade agreement specify the language of the contracts. The specification of the language before the commencement of negotiations on a supply contract may facilitate preparations of the parties for the negotiations and avoid a disagreement.

11. Drawing up a contract in only one language version will reduce conflicts of interpretation in regard to its provisions. Drawing up all the contracts constituting the countertrade transaction in the same language will reduce conflicts between two contracts of related content. On the other hand, each party may understand its rights and obligations more easily if one version of the contract is in its language. In addition, where extensive or complex working instructions to personnel of one or both parties are derived directly from the contract, it may be of particular importance that the contract is in the language in which the instructions are to be given. The parties may decide that certain annexes to the countertrade agreement or a supply contract (e.g., those setting out technical specifications) will be drawn up in or translated into a particular language. If translations are envisaged, it is advisable to settle the question of who should bear the translation costs. If only one language is to be used, the parties may wish

to take the following factors into account in choosing that language: that it is advisable for the language chosen to be understood by the senior personnel of each party who will be implementing the contract; that it might be advisable for the contract to be in a language commonly used in international commerce; that the settlement of disputes is likely to be facilitated if the language chosen is the language in which proceedings would be conducted or if the language chosen is the language or one of the languages of the country of the applicable law.

12. If the parties do not draw up the contracts in a single language version, it is advisable to specify in the contracts which language version is to prevail in the event of a conflict between the two versions. For example, if the negotiations were conducted in one of the languages, the parties may wish to provide that the version in the language of the negotiations is to prevail. A provision that one of the language versions is to prevail might induce both parties to clarify as far as possible the prevailing language version. The parties may wish one language version to prevail in respect of certain segments of the transaction or in respect of certain contract documents (e.g. countertrade agreement or technical documents related to the countertrade agreement or a supply contract) and another language version in respect of the remainder of the contracts or documents. Where the parties provide that both language versions are to have equal status, the parties should attempt to provide guidelines for the settlement of a conflict between the two language versions. The parties may provide, for example, that the agreement is to be interpreted according to practices that the parties have established between themselves and usages regularly observed in international trade with respect to the agreement in question. The parties may also wish to provide that where a term of the contract in one language version is unclear, the corresponding term in the other language version may be used to clarify that term.

C. Parties to transaction

13. Where a contract involved in the transaction (the countertrade agreement or a supply contract) consists of several documents, the parties may wish to identify and describe themselves in a principal document designed to come first in logical sequence among the documents that incorporate that contract. The document should set forth, in a legally accurate form, the names of the parties, indicate their addresses, record the fact that the parties have entered into a contract, briefly describe the subject-matter of the contract, and be signed by the parties. It should also set forth the date on which, and the place where, the contract was signed, and the time when it is to enter into force. Subsequent reference in the contract to the parties may be facilitated if the principal document would specify that in the subsequent text and in the subordinate documents the parties would be referred to by agreed abbreviations or by expressions such as exporter, importer, counter-exporter, counter-importer, trading house. A party may have several addresses (e.g., the address of its head office, the address of a branch through which the contract was negotiated) and it may be preferable to specify in the document the address to which notifications directed to a party should be sent.

14. Parties to countertrade transactions are usually legal persons. In such cases the source of their legal status (e.g. incorporation under the laws of a particular country) may be set out in the contract. There may be

limitations on the capacity of legal persons to enter into contracts. Therefore, unless satisfied of the other party's capacity to enter into the contract, each party may wish to require from the other some proof of that capacity. If a party to the contract is a legal person, the other party may wish to satisfy itself that the official of the legal person signing the contract has the authority to bind the legal person. When a governmental agency is a party to the countertrade transaction, special authorization may be necessary for the conclusion of the countertrade agreement or the supply contract. Special authorization may also be required for a governmental agency to enter into an arbitration agreement and to include in that agreement a clause by which the agency agrees to carry out the award made by the arbitral tribunal.

15. [paragraph 14, last sentence] If the contract is entered into by an agent on behalf of a principal, the name, address and status of the agent and of the principal may be identified, and evidence of authority from the principal enabling the agent to enter into the contract on its behalf may be annexed.

D. Notifications

16. [15] In a countertrade transaction a party frequently has to notify the other party of certain events or situations. Such notifications may be required, for example, to initiate negotiations for the conclusion of a supply contract, to facilitate cooperation in the performance of the contract, to enable the party to whom notification is given to take action, as the prerequisite to the exercise of a right, or as the means of exercising a right. The parties may wish to address and resolve in their contract certain issues which arise in connection with such notifications.

17. [16] In the interests of certainty, it is desirable to require that all notifications referred to in the countertrade transaction be given in writing, although in certain cases requiring immediate action the parties may wish to provide that notification can be given orally in person or by telephone, to be followed by confirmation in writing. The parties may wish to define "writing" (see paragraph 21 below) and to specify the acceptable means of conveying written notifications (e.g., surface mail, airmail, telex, telegraph, facsimile, electronic data interchange (EDI)). However, care should be taken not to so limit the means of notification that, if the means specified is not available, no valid notification could be given. The parties may also wish to specify the language in which notifications are to be given (e.g., the language of the contract).

18. [17] With regard to the time when a notification is to be effective, two approaches may be considered. One approach is to provide that a notification is effective upon its dispatch by the party giving the notification, or after the lapse of a fixed period of time after the dispatch. Alternatively, the parties may provide that a notice is effective only upon delivery of the notification to the party to whom it is given (see paragraph 21 below). Under the former approach, the risk of a failure to transmit or an error by the transmitting agency in transmission of the notification rests on the party to whom the notification is sent, while under the latter approach it rests on the party dispatching the notification. The parties may find it advantageous to select a means of transmitting the notification which provides proof of the dispatch or delivery, and of the time

of dispatch or delivery. Another approach may be to require the party to whom the notification is given to acknowledge receiving the notification. It may be convenient for the contract to contain a general provision to the effect that, unless otherwise specified, one or the other approach with respect to when a notification becomes effective (on dispatch or delivery) is to apply to notifications referred to in the contract. Exceptions to the general approach adopted may be appropriate for certain notifications.

19. [New paragraph] The parties may wish to specify the addresses of company departments or of representatives of the parties to which notifications should be sent. Different addressees might be specified for different kinds of notifications.

20. [18] The parties may wish to specify the legal consequences of a failure to notify. The parties may also wish to specify the consequences of a failure to respond to a notification that requires a response. For example, when the parties envisage a series of shipments in one or in the two directions, they may provide that if the supplier notifies the purchaser of a proposed shipment of a given quantity of the goods on a particular date, the purchaser is deemed to have agreed unless an objection is made.

E. Definitions

21. [19] It is advisable to define certain key expressions or concepts that are frequently used in the countertrade agreement or in the supply contract. Definitions are particularly useful in contracts between parties from different countries, even if they use the same language, because of the increased possibility that certain expressions or concepts may be used differently in the two countries. Definitions are also useful when the contracts are in two languages since they tend to reduce the likelihood of errors in translation. A definition ensures that the expression or concept defined is understood in the same sense whenever it is used in the agreement or the contract, and dispenses with the need to clarify the intended meaning of the expression or concept on each occasion that it is used. A definition is advisable if an expression which needs to be used is ambiguous. Such definitions are sometimes made subject to the qualification that the expressions defined bear the meanings assigned to them, "unless the context otherwise requires". Such a qualification takes into account the possibility that an expression which has been defined has inadvertently been used in a context in which it does not bear the meaning assigned to it in the definition. The preferable course is for the parties to scrutinize the contract carefully to ensure that the expressions defined bear the meanings assigned to them wherever they occur.

22. [20] Since a definition is usually intended to apply throughout an agreement or contract, a list of definitions may be included in the controlling document. Where, however, an expression that needs to be defined is used only in a particular provision or a particular section of the agreement or contract, it may be more convenient to include a definition in the provision or section in question.

23. [21] Examples of expressions that parties may wish to define include "countertrade agreement", "writing", "dispatch of notification", and "delivery of notification". The parties may wish to consider the following examples:

> Countertrade agreement. "Countertrade agreement" consists of the following documents, and has that meaning in all the said documents: (a) the present document; (b) list of possible countertrade goods; (c) ... .
>
> Writing. "Writing" includes statements contained in a telex, telefax, telegram or other means of telecommunication which provides a record of the content of such statements.
>
> Dispatch of a notification. "Dispatch of a notification" by a party occurs when it is properly addressed and conveyed to the appropriate entity for transmission by a mode authorized under the contract.
>
> Delivery of a notification. "Delivery of a notification" to a party occurs when it is handed over to that party, or when it is left at an address of that party at which, under the contract, the notification may be left, irrespective of whether the notification is brought to the attention of the individual responsible to act on the notification.

24. [22] The parties may find it useful, when formulating their own definitions, to consider the descriptions contained in the present Guide of the various concepts commonly used in countertrade transactions. Those descriptions can be located by the use of the index to this Guide.

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INTERNATIONAL COUNTERTRADE

Draft Legal Guide on International Countertrade Transactions

Report of the Secretary-General

Addendum

VI. TYPE, QUALITY AND QUANTITY OF GOODS

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[Editorial note: The present draft chapter VI is a revision of draft chapter V, "Type, quality and quantity of goods", published as document A/CN.9/332/Add.4. The note in square brackets at the beginning of each paragraph indicates either that the paragraph is new or it refers to the number under which the paragraph appeared in document A/CN.9/332/Add.4. The revisions of paragraphs that appeared in A/CN.9/332/Add.4 are underlined. An asterisk indicates the place where text has been deleted without adding new language.]

A. General remarks

1. [new paragraph] As noted in chapter II, paragraph 2, the discussion concerning "goods" in the Legal Guide is broadly applicable to services and technology. Where necessary, the present chapter makes reference to certain special issues concerning services and technology.

2. [1] The parties may either identify in the countertrade agreement the type of goods that will be the subject of the future supply contract, possibly stating only broad categories of goods, or not stipulate the type of goods. The more precise the countertrade agreement is with respect to the type of goods, the greater the possibility is of stipulating in the countertrade agreement the quantity and quality of the goods. Precision as to type, quality and quantity increases the likelihood that the intended supply contract will be concluded. Sometimes, even though the type of countertrade goods is identified in the countertrade agreement, the exact quality and quantity of the goods are left for later determination because the conditions on which the parties wish to base their decision on quantity and quality are not yet fully known. *

B. Type of goods

1. General remarks

3. [2] Various considerations may enter into the selection of the type of goods. The supplier would prefer that the goods be those that could easily be made available or those that the supplier wishes to introduce in a new market, while the purchaser would like to purchase goods that are needed or could be resold easily. The freedom of the parties to agree on the type of goods to be supplied in one or both directions may be affected by government regulations dealing specifically with the types of goods that may be involved in countertrade transactions. For example, in some countries government regulations exclude certain types of goods from being offered for purchase in a countertrade transaction if the price of the goods is not paid in foreign currency to the the exporter's account. * Government regulations may also provide that the import of certain types of goods is permitted only if the exporter agrees to purchase goods in return.

4. [3] The choice of the parties as to the type of goods may also be restricted by government regulations requiring that the countertrade goods must originate in the country, or in a particular region of the country, or must be purchased from a particular economic sector or group of suppliers. Such restrictions on origin and source are particularly likely to be encountered when the party requiring a countertrade commitment is a

governmental entity. * Clauses in the countertrade agreement concerning origin and source restrictions are discussed in chapter IV, "Countertrade commitment", paragraphs 26 to 28, and chapter VIII, "Participation of third parties", paragraphs __ to __. In addition to regulations specific to countertrade referred to in the previous two paragraphs, there may exist restrictions generally applicable to the export or the import of goods which could affect the freedom of the parties to select the types of goods to be traded under the countertrade transaction.

5. [new paragraph] Parties may wish to be assured, prior to entering into the countertrade transaction, that, if the prescribed conditions are met, there are in principle no obstacles to obtaining the required export and import licences. Such an assurance, which may be given by a party to the transaction or by a third person, may be appropriate, for example, in countertrade transactions that require committing large portions of production capacity or disclosure of technological information. In such transactions the denial of a licence could pose greater difficulties than a similar denial in a simple sales transaction.

6. [new paragraph] If a governmental restriction on the export or import of goods is imposed after the parties have agreed on the type of goods, the parties would be impeded in the carrying out of the countertrade commitment or of a supply contract. Such impediments are discussed in chapter XIII, "Failure to complete countertrade transaction", paragraphs ___ .

2. List of possible goods

7. [4] When the parties conclude a countertrade agreement without determining the type of goods, they may wish to include in the countertrade agreement a list of possible countertrade goods, the purchase of which would count toward fulfilment of the countertrade commitment. Where the countertrade agreement is concluded prior to the supply contracts pertaining to deliveries in both directions (chapter III, "Contracting approach", paragraphs 20 and 21), there may be two lists, one for each direction in which goods will be shipped. The product list may be attached to the countertrade agreement at the time of signature or may be agreed upon later.

8. [5] The countertrade agreement should be clear as to the nature and extent of the undertaking of the parties with respect to a list of possible countertrade goods. The supplier may undertake to make available all the types of goods on the list. In such a case the purchaser would be free to choose from among different types of goods appearing on the list, unless the countertrade agreement restricts the purchaser's choice. For example, there may be a limit on the number of different types of goods that may be purchased or there may be minimum or maximum levels set for the purchase of certain types of goods.

9. [6] The undertaking of the supplier as to availability may be limited to certain specified types of goods on the list. In such a case, the purchaser would be free to choose from among the goods that are identified in the countertrade agreement as being available. The possibility of purchasing any of the other types of goods, whose availability is not assured, would be left to subsequent negotiation.

10. [7] It may be agreed that the purchaser's commitment is to be reduced to the extent the supplier fails to make available those types of goods that are identified in the countertrade agreement as being available (see chapter XIII, "Failure to complete countertrade commitment", paragraphs ___). In addition, the supplier's commitment to make available goods appearing on a list may be supported by a liquidated damages or penalty clause (see chapter XI, "Liquidated damages and penalty clauses") or a guarantee (chapter XII, "Security for performance").

11. [8] When the supplier does not make an undertaking as to the availability of any particular type of goods appearing on the list, the determination of the types of goods actually available will occur in the course of the subsequent negotiations. If the supplier fails to make available any of the goods on the list, the purchaser would not be liable for the failure to fulfil the countertrade commitment (see chapter XIII, "Failure to complete countertrade commitment", paragraphs ____).

12. [9] The parties may wish to state in the countertrade agreement that the purchaser is obligated to supply within a specified time period the specifications necessary to establish accurately the purchaser's requirements with respect to the goods to be purchased and to enable the supplier to make a corresponding offer. The countertrade agreement may indicate that specifications will be provided by a third party (e.g., a trading house engaged to purchase the goods, or an end-user).

13. [10] Because countertrade agreements are often entered into for the purpose of developing new exports or new markets for existing exports, selection of the countertrade goods could be conditioned on a requirement that the goods be a non-traditional export of the supplier or, if they are a traditional export, that they be resold in a new market. Where the purchaser has made prior purchases from the supplier or has a prior commitment to purchase goods from the supplier, the countertrade agreement may stipulate that the purchase is to be of a new type of goods and must result in a level of sales higher than established levels in order to be counted towards fulfilment (see also chapter IV, paragraphs 5 and 6, concerning "additionality" as a factor in setting the extent of the countertrade commitment). It is advisable that the countertrade agreement define the requirements as to new products or markets, either by identifying products and markets considered new or identifying those not considered new.

14. [11] Establishing a procedure in the countertrade agreement for making decisions on the type of countertrade goods may be helpful, particularly in a long term countertrade transaction or one involving multiple parties. For example, the parties may wish to form a joint committee that would meet at regular intervals to identify countertrade goods and to monitor fulfilment of the countertrade commitment. Procedures established for identifying countertrade goods should be coordinated with deadlines in the fulfilment schedule. (See chapter IV, "Countertrade commitment", paragraphs 17 to 20; for a general discussion of negotiation, see chapter IV, paragraphs 56 to 60). Such a joint committee might also be utilized to settle the price of the goods (see chapter VII, "Pricing of goods", paragraph __).

3. Services

15. [new paragraph] When services are to be a subject-matter of a supply contract, it is advisable that the countertrade agreement be as specific as possible in describing them. Even if certain aspects of the envisaged service cannot be agreed upon at the time of entering into the countertrade agreeement, the parties may facilitate subsequent negotiations and increase the likelihood of concluding the intended contract if they describe in the countertrade agreement those aspects of the service that they are in a position to agree on. The descriptions will depend on the type of the service envisaged. For example, if transport is the subject-matter of the future contract, the issues that the parties might be able to address in the countertrade agreement include the following: the routes, type of vehicles or vessels to be used, any special equipment that the carrier must have available, types of goods to be transported, special considerations concerning dangerous goods, any permits that may be necessary to effect the transport and the party responsible to obtain the permits. If maintenance of industrial equipment is the service in question, the countertrade agreement might, for example, outline certain of the elements of a maintenance programme, including the level of efficiency at which the equipment is to be maintained. Such elements could include, for example, periodic inspection of the equipment; maintenance manual and procedures; cleaning; adjustment and lubrication; replacement of defective or worn-out parts; the period of time during which maintenance is to be provided; maintenance schedules; maintenance records; obligations of the parties with respect to unforeseen breakdowns and repairs; manner of calculating the price of the service.

4. Technology

16. [new paragraph] Countertrade transactions may involve the transfer of technological processes necessary for the manufacture of products or the transfer of knowledge and skills necessary to use particular industrial equipment. The communication of these processes, knowledge and skills is often referred to as the transfer of technology. When the transfer of technology is involved in a countertrade transaction, it is usually part of the export contract, i.e., the contract that is entered into at the outset of the countertrade transaction together with the countertrade agreement stipulating the conclusion of a counter-export contract. For example, export contracts in buy-back and indirect offset transactions include the transfer of technology. In some countertrade transactions, however, the countertrade agreement envisages technology to be transferred in connection with a supply contract to be concluded.

17. [new paragraph] The transfer of technology may occur in different ways. It may occur through the grant of licences to use industrial products or processes that are the subject of different forms of industrial property. Most legal systems provide for the registration, subject to certain conditions, of inventions of industrial products or processes which are thereby recognized and protected under the law relating to industrial property in force within the territory of the country in which the registration takes place. The owner of the industrial property obtains the exclusive right to exploit the products or processes that are the subject of the industrial property. A common form of industrial property protection consists of patents. Once a patent is granted, for a limited period determined by law, the invention that is the subject-matter of the patent can be exploited in the

country that granted the patent only with the consent of the patent holder. A person can apply in more than one country for the grant of a patent. There exist international treaties according to which the registration of an invention with the designated international office provides national patent protection in the States members of the treaty; such treaties are, for example, the European Patent Convention of 1973 and the treaty establishing the African Intellectual Property Organization of 1962 and 1977. Most legal systems also recognize other forms of industrial property. For example, a distinctive sign used to identify goods and indicate their origin (e.g., as coming from a particular manufacturer) may be protected through registration as a trade mark. A protected trade mark cannot be used without the consent of the registered owner of the trade mark. The transfer of technology may occur in conjunction with a license for the use of a trade mark. A patent holder or the owner of a trade mark may license the use of the patent or trade mark (i.e., permit, subject to the conditions of the licence, to use the subject-matter of the patent, or the trade mark, in return for remuneration). Some legal systems recognize additional forms of industrial property, such as utility models and industrial designs.

18. [new paragraph] When the purchaser requires a particular technology, it is advisable that the countertrade agreement contain as precise as possible a description of that technology. In some cases, however, the purchaser may prefer the obligations of the supplier of the technology to be defined primarily in terms of certain performance parameters to be achieved by the use of the technology (e.g., production of goods of a quantity and quality stipulated in the contract). In such cases, a general description of the technology may be sufficient for the countertrade agreement, and the supplier may be required to provide the detailed description upon the conclusion of the supply contract.

19. [new paragraph] Certain industrial processes may be known only to one or a few enterprises. These enterprises might not wish, or may have been unable, to protect the industrial processes through registration in accordance with the law relating to industrial property. They may, instead, keep this knowledge confidential. In such cases, the transfer of technology may occur through the supply of this knowledge (generally called "know-how"). Such transfer of know-how may be subject to conditions as to the maintenance of confidentiality by the party to whom the know-how has been transferred. The information and skills necessary for the operation and maintenance of a plant may be communicated through the training of personnel or through documentation. A given transaction may involve the transfer of technology through one or more of the methods described in this and the previous paragraph.

20. [new paragraph] The supplier of know-how will usually require the know-how to be kept confidential. Confidentiality may be required at two stages. Firstly, the supplier may provide some information relating to the know-how during negotiations for the conclusion of the countertrade agreement in order to enable the purchaser to decide whether it wishes to enter into a countertrade agreement, and to make proposals as to contract terms. The supplier will wish the purchaser to keep this know-how confidential. Secondly, when a supply contract is entered into pursuant to the countertrade agreement, the supplier will require the additional know-how supplied thereafter to be kept confidential. To achieve these results, it may be necessary under some legal systems for the parties, prior to the commencement

of negotiations, to conclude an agreement under which the purchaser undertakes to maintain confidentiality with regard to know-how supplied during negotiations, and thereafter to include provisions on confidentiality in the countertrade agreement and in the supply contract. Under other legal systems, however, the obligation of the purchaser to maintain confidentiality results from the obligation of the parties to observe good faith during negotiations. The supplier may wish to consider whether it is necessary to supplement by an express stipulation any obligation to maintain confidentiality imposed by law.

21. [new paragraph] The extent to which contractual provisions may impose obligations as to confidentiality on the purchaser may be regulated by mandatory legal rules. Issues to be addressed by such contractual provisions may include clear identification of the know-how to be kept confidential, the duration of the confidentiality and the extent of permissible disclosure (e.g., disclosure being permissible in specified circumstances, or to specified persons). The parties might seek to provide that once the know-how to be kept confidential becomes available to the public, the obligation of confidentiality terminates, as does the obligation to pay royalties. The parties may also wish to provide, for example, that a person engaged by the purchaser to advise the purchaser in connection with the supply contract is to be allowed access to such of the know-how as is necessary for the exercise of the advisory functions. They may further wish to provide that if the countertrade agreement or the supply contract is terminated because of a failure on the part of the supplier, and the purchaser wishes to achieve the objective of the supply contract by engaging another supplier, the purchaser may disclose to the other supplier such part of the know-how as is necessary for achieving that objective. The purchaser may, however, be obligated to obtain from its adviser or the other supplier prior to the disclosure of the know-how an undertaking that the adviser or the other supplier will not disclose the know-how to others.

22. [new paragraph] An obligation of confidentiality may need to be imposed on the supplier of the technology, for example, when the purchaser is to have exclusive use of the technology, or when the supplier of the technology is to receive improvements to the technology made by the purchaser. In formulating a contractual provision for this purpose, the discussion in the previous two paragraphs may be useful.

23. [new paragraph] This Legal Guide does not deal comprehensively with contract negotiation relating to the licensing of industrial property, or the supply of know-how, since this subject is not specific to countertrade and has been dealt with in detail in publications issued by United Nations bodies. 1/

C. Quality of goods

24. [12] The question of quality of countertrade goods raises two main issues that the parties may wish to address in the countertrade agreement. The first involves specifying the level of quality that the goods must meet; the second involves establishing procedures to ascertain, before the conclusion of a supply contract, that goods being offered meet the specified level of quality (pre-contractual inspection). Agreement on both aspects of quality may help the parties to avoid disagreements over such questions as

whether the party committed to purchase countertrade goods is obligated to purchase particular goods offered by the supplier or whether the goods are worth the price at which they are offered.

1. Specifying quality

25. [13] If the type of goods is not identified in the countertrade agreement, or is identified only by broad categories, precise statements of quality cannot be made. In such cases, the parties may only be able to state quality requirements in general terms such as "export", "prime" or "marketable" quality. When the type of goods is identified, it is advisable to be as precise as possible with respect to quality. If the goods are commodities or semi-manufactured goods with standardized levels of quality (e.g., wire, steel sheets or petro-chemical produts), it may be sufficient to use general statements of quality or descriptors of a particular grade of quality. In the case of manufactured goods, it is advisable to define the quality in a more specific way, for example, by referring to a quality standard, the purpose for which the goods must be fit, packaging, or safety and environmental requirements.

26. [new paragraph] It should be noted that the quality of goods may be subject to standards of various kinds. There may be mandatory regulations prescribing certain measurable standards that goods must meet. In addition, the level of quality to be expected from goods may be a matter of trade usage in a particular market or industrial sector. Furthermore, quality standards may be enunciated in court decisions, for example, when a producer of a product is held liable for damage caused to the user of the product because in view of the court the design of the product was not safe. Moreover, there may exist non-mandatory quality standards or recommendations adopted by bodies such as trade associations, chambers of commerce or associations of users or consumers. Non-mandatory standards may also be established by governmental agencies entrusted with formulating and updating standards for commercial goods and services. Quality standards emanating from the foregoing sources may differ among countries or markets. Major differences may exist in particular with regard to consumer goods or services. In order to avoid disagreements, it is advisable that the countertrade agreement specify the standards that the countertrade goods must meet and, if the understanding of a quality standard may vary, it is advisable to link it to a particular country or market.

27. [new paragraph] When a particular type of service will be a subject-matter of a future supply contract, it is desirable that the countertrade agreement specify the quality standards to be observed in performing the service. If norms established by professional bodies are available, the quality of the service may be described by reference to those norms. Where such norms are not available, the countertrade agreement may stipulate that the service is to be effected in accordance with the standards that would be observed by a professional providing that kind of service. If professional standards differ, it is advisable that the parties specify the country whose professional standards should apply.

28. [14] The parties may wish to address in the countertrade agreement, i.e., prior to the conclusion of a supply contract, the remedies of the purchaser in the event that goods delivered under supply contracts concluded subsequently do not meet quality standards stipulated in the countertrade

agreement or in the individual supply contract. By including such provisions in the countertrade agreement, the parties could avoid negotiating the question of the purchaser's remedies each time a supply contract is concluded.

2. Pre-contractual quality control

29. [15] This section deals with pre-contractual quality control, i.e., quality control carried out before the conclusion of a supply contract by the party committed to purchase in order to establish whether the goods offered conform to the quality standards set in the countertrade agreement. If several shipments of goods are intended, the parties may agree that pre-contractual quality control will be carried out on all goods intended to be the subject-matter of future supply contracts or only on some portions of those goods. Pre-contractual quality control is likely to reduce the possibility that, after a supply contract is concluded, the goods are discovered not to meet the agreed quality standards. It may be noted that a supply contract itself may provide for a quality inspection before the goods are shipped by the supplier ("pre-shipment inspection"). Such pre-shipment inspection, which relates to the performance of a concluded supply contract, is not specific to countertrade and is therefore not discussed in the Legal Guide.

(a) Identity of inspector

30. [16] The pre-contractual quality control may be conducted by an inspector designated either by the party committed to purchase or by the parties jointly. When the inspector is to be designated jointly, the parties may wish to stipulate in the countertrade agreement criteria for the selection of the inspector. When the type of goods has been identified, the parties are in a better position to name the inspector since the subject-matter in which the inspector would need expertise is known to the parties.

(b) Inspection procedures

31. [17] It is advisable that the parties agree on various aspects of the inspection procedure such as: the location and time of inspection; the time-frame for inspection; the manner of notifying the parties of the inspection results; the mandate of an inspector to be designated jointly; whether, in the case of an inspector designated by the purchaser, the supplier will be informed of the inspector's mandate; the inspector's duty of confidentiality; deadlines for submission of the inspector's report; a requirement that reasons be stated for a finding that the goods are non-conforming; whether sampling and testing procedures customarily used in a particular trade suffice or whether ad hoc procedures need to be established; additional inspections or tests when the result of an inspection is contested (e.g., it may be agreed that a party could request a further inspection to be conducted by a second inspector, that in the interest of finding a quick solution the second inspection should be carried out within short time-limits, that an experienced and independent quality arbitrator be engaged for this purpose, and that the second inspection would be controlling); and cost of inspection.

(c) Effect of inspector's finding

32. [18] It may be agreed that the inspector's finding would be regarded as a statement of opinion on the basis of which the parties would consider what steps to take. Alternatively, it may be agreed that a finding by the inspector as to the quality of the goods would directly affect the contractual relationship of the parties. For example, it may be agreed that in the event that the inspector finds that the goods conform to the quality standard stipulated in the countertrade agreement, and if the parties have agreed on the essential terms of a supply contract, the parties are deemed to have concluded the supply contract. In the event of a negative finding, the supplier's offer to conclude a supply contract would be deemed not accepted and the rejection of the goods in question would not constitute a breach of the countertrade commitment. The parties might agree that a negative finding and the rejection of the goods do not affect the extent of the countertrade commitment. Alternatively, it might be agreed that in the case of a negative finding, or in the case that two consecutive offers of the same type of goods are rejected as a result of a negative finding, the party committed to purchase would be released from the countertrade commitment up to the value of the goods refused (see also chapter XIII, "Failure to complete countertrade transaction", paragraph [6]). Where the countertrade agreement envisages various levels of quality, it may be agreed that the inspector's finding as to quality would be used in a formula for determining the price of the goods.

D. Quantity of goods

33. [19] When the countertrade commitment refers to goods of one specified type, the quantity of goods to be purchased may be stipulated in the countertrade agreement or left to be determined at the time of the conclusion of the supply contracts *. When the parties express the countertrade commitment as a monetary amount, rather than as a quantity of goods to be purchased, they may wish to postpone determining the quantity until the conclusion of the supply contract. Such a postponement would allow fluctuations in the unit price of the goods to be taken into account. An increase in the unit price would mean a reduction in the quantity of goods to be purchased, while a drop in the unit price would mean an increase in the quantity to be purchased. When the countertrade commitment is expressed in terms of the number of units to be purchased, the parties may wish to stipulate a minimum monetary amount so that, in the event of a drop in the unit price, additional units would have to be purchased.

34. [20] When the countertrade agreement provides for several possible types of goods, the quantity of each type of goods that will be purchased may be left to be determined at the time of the conclusion of the supply contracts. The overall value of the purchases would have to be in conformity with the extent of the commitment set in the countertrade agreement. The countertrade agreement may specify the minimum and maximum percentages of the countertrade commitment that may be fulfilled by purchase of each type of goods.

35. [21] Where the parties are not in a position to determine quantity in the countertrade agreement, it may be useful for the countertrade agreement to set a deadline for agreement on quantity. The parties may refer to a specific date (e.g., 30 days before the close of a subperiod of the fulfilment period)

or to an event in the contract in the other direction (e.g., in a buy-back transaction it may be agreed that quantity is to be determined upon the start-up of the plant delivered under the export contract).

36. [22] It may also be agreed that, at specified points in the period for the fulfilment of the countertrade commitment, a party committed to purchase would be obligated to provide an estimate of the quantities of goods expected to be purchased in the upcoming period of time. Similarly, a party committed to supply goods may agree to periodically provide an estimate of the quantity of goods expected to be made available. The parties may wish to agree on a permitted deviation between the estimated quantities and the quantities actually purchased or made available.

37. [23] When the proceeds of the export contract are to be used to pay for the counter-export contract, it is advisable that the parties ensure that the quantity purchased under the export contract is such that the proceeds of the export contract would cover payment for the counter-export contract. Payment mechanisms used in such cases are discussed in chapter IX.

38. [24] If the parties foresee the possibility of purchases of quantities beyond those stipulated in the countertrade agreement, they may wish to consider whether the purchaser's additional orders will be granted any preference over other potential buyers. A related issue is whether the additional quantities would be supplied on the same terms as the original quantities envisaged in the countertrade agreement.

39. [25] The parties may leave the quantity of goods to be determined on the basis of the purchaser's requirements. In such cases, the parties may wish to consider whether the supplier is to be the purchaser's single source for the goods and whether the purchases are to fall within a range specified in the countertrade agreement. The quantity of the goods may also be determined on the basis of the supplier's output of a given product. This approach may be used, for example, in a buy-back transaction. In this case too, the parties may wish to stipulate that the purchases are to fall within a range set in the countertrade agreement.

[Two paragraphs on "additionality", which appeared in the earlier draft chapter entitled "Type, quality and quantity of goods" (A/CN.9/332/Add.4, paragraphs 26 and 27), were moved to chapter IV, "Countertrade commitment" (A/CN.9/362/Add.4) paragraphs 5 and 6.]

E. Modification of provisions on type, quality and quantity

40. [28] A need for a review of provisions on type, quality or quantity of goods may arise due to the unavailability of goods specified in the countertrade agreement, the desire to place additional products on a list, a change in the commercial conditions underlying the transaction, a shift in the commercial objectives of the parties or a governmental regulation affecting the choice of countertrade goods. It could be agreed, particularly in long term transactions, that the parties would review the provisions on type, quality and quantity of goods either at regular intervals or in response to changes in circumstances stipulated in the countertrade agreement (e.g., a change beyond a certain threshold in the price of the goods). The review could be carried out within the framework of a mechanism for monitoring and

coordinating fulfilment of the countertrade commitment (see chapter IV, "Countertrade commitment", paragraphs 61 to 74).

41. [29] In order to avoid a modification procedure, the parties may wish to provide that under certain conditions fulfilment credit would be earned by the purchase of goods other than those agreed upon in the countertrade agreement or appearing on a list of possible countertrade goods. For example, it might be required that the purchases in question meet an additionality test (chapter IV, "Countertrade commitment", paragraphs 5 and 6), or it may be stipulated that they would earn fulfilment credit at a reduced rate (for further discussion of clauses allowing non-conforming purchases to be counted toward fulfilment of the countertrade commitment, see chapter IV, paragraph 30).

Note

1/ The negotiation and drafting of contracts for the licensing of industrial property and the supply of know-how is dealt with in detail in World Property Organization, Licensing Guide for Developing Countries (WIPO publication no. 620(e), 1977). The main issues to be considered in negotiating and drafting such contracts are set forth in Guidelines for Evaluation of Transfer of Technology Agreements, United Nations Industrial and Development Organization, Development and Trasfer of Technology Series, No. 12 (ID/233, 1979), and in the Guide for Use in Drawing Up Contracts Relating to the International Transfer of Know-How in the Engineering Industry (United Nations publication, Sales No. E.70.II.E.15). Other relevant publications are the Handbook on the Acquisition of Technology by Developing Countries (UNCTAD/TT/AS/5, 1978) and Guide to Guarantee and Warranty Provisions in Transfer-of-Technology Transactions, United Nations Industrial and Development Organization (prepared jointly by the secretariats of the United Nations Industrial and Development Organization and the International Center for Public Enterprises in Developing Countries) (ID/355, 1989). A manual on technology transfer is currently under preparation by the United Nations Industrial and Development Organization.

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INTERNATIONAL COUNTERTRADE

Draft Legal Guide on International Countertrade Transactions

Report of the Secretary-General

Addendum

VII. PRICING OF GOODS

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[*Editorial note*: The present draft chapter VII is a revision of draft chapter VI, "Pricing of goods", published as document A/CN.9/332/Add.5. The note in square brackets at the beginning of each paragraph indicates either the number under which the paragraph appeared in document A/CN.9/332/Add.5 or that the paragraph is new. The revisions of paragraphs that appeared in document A/CN.9/332/Add.5 are underlined.]

A. *General remarks*

1. [1] It is advisable that the parties specify in the countertrade agreement the price of the goods that will be the subject-matter of the future *supply contract*. When the parties are not able to set the price in the countertrade agreement, it is advisable to provide a method *according to which the price will be determined at the time the supply contract is to be concluded. When contracts are to be concluded in both directions, methods for price determination may be agreed for contracts in each of the two directions.* This chapter deals with methods for determining the price after the countertrade agreement has been concluded. *It also deals with certain questions encountered in the specific contexts of supplying services and the transfer of technology.* In addition, the chapter discusses the currency in which the price is expressed and revision of price.

2. [2] The parties may need to defer setting the price, for example, because the *specific* type of goods has not been identified at the time of the conclusion of the countertrade agreement or because there is to be a long interval between the conclusion of the countertrade agreement and the conclusion of a given supply contract. Such an interval may prompt the parties to defer setting the price because of the possibility of price fluctuation or of a change in the underlying economic conditions during the interval. In some cases, the parties may set the price of an initial shipment, but leave the determination of the price of subsequent shipments for a later time. Providing a method for determining the price may help the parties avoid differences over what the appropriate price should be, which may delay or prevent the conclusion of supply contracts. *Such differences may be compounded when a party expects a supply contract in one direction not to be profitable and wishes to offset the expected loss in setting the price for the contract in the other direction.*

3. [3] In a barter transaction, it may not be necessary to include a provision on price because the goods shipped in one direction constitute payment for the goods shipped in the other direction. Nevertheless, pricing issues may arise in a barter transaction if the parties decide to measure the relative value of their shipments in monetary terms, rather than merely in terms of volume and quality, or if the shipments are of different values and the imbalance is to be settled in money. Pricing would also be necessary when customs regulations require that goods entering a country indicate a monetary value.

4. [4] In setting the price of the countertrade goods, it is advisable that the parties specify whether or not the price includes costs ancillary to the costs of the goods themselves, such as transportation or insurance, testing, or customs duties and taxes. Some of the elements of the price may

be indicated by using an appropriate trade term such as those defined in INCOTERMS 1990 of the International Chamber of Commerce.

5. [5] The parties may wish to stipulate the point of time when the price is to be calculated, particularly in the case of goods whose price may fluctuate. When the countertrade transaction involves a single shipment or a number of shipments within a relatively short period of time, and the price is to be determined only once, a specified date may be agreed upon. In some cases, the price setting mechanism may be set in motion by an event such as the start-up of a plant under a buy-back transaction or the placing of an order. When multiple shipments are spread out over a longer period of time, several dates for determination of price may be agreed upon or the countertrade agreement may provide a mechanism for revision of the initial price.

6. [6] The parties should bear in mind that there may be mandatory rules that affect the level at which the price may be set. For example, if the price is set at a low level in relation to the market price, the goods may be subject to anti-dumping import duty.

B. Currency of price

7. [7] The currency in which the price is to be paid may involve certain risks arising from the fluctuation in exchange rates between that currency and other currencies. If the price is to be paid in the currency of the supplier's country, the purchaser bears the consequences of a change in the exchange rate between that currency and the currency of the purchaser's country. The supplier, however, will bear the consequences of a change in the exchange rate between the currency of the supplier's country and the currency of another country in which the supplier has to pay for equipment, materials or services needed in the production of the goods. If the price is to be paid in the currency of the purchaser's country, the supplier bears the consequences of a change in the exchange rate between this currency and the currency of the supplier's country. If the price is to be paid in the currency of a third country, each party bears the consequences of a change in the exchange rate between this currency and the currency of its respective country. Where a financing institution has granted the purchaser a loan for the purchase of the goods, the purchaser may prefer the price to be paid in the currency in which the loan is granted.

8. [8] In stipulating the currency in which the price is to be paid, the parties should take into consideration foreign exchange regulations and international treaties in force in the countries of the supplier and the purchaser, which may mandatorily govern this question. The parties should also take into account that under some legal systems the price in an international contract must be paid in the currency in which it is denominated, while other legal systems may permit, or even require, payments in the currency of the place of payment, even if the price is denominated in a convertible currency.

9. [9] The countertrade agreement may denominate the price in a currency that the parties consider to be stable or in a unit of account that is not a national currency, but provide that it is to be paid in another currency. The effects of such an approach are similar to those achieved by a currency clause

(see below, paragraphs 48 to 50), and restrictions imposed by the applicable law in respect of currency clauses may also apply to such provisions. If this approach is used, it is advisable to agree in the countertrade agreement that the exchange rate is to be the one prevailing at a specified place on a specified date.

10. [10] It is not advisable for the contract to denominate the entire price in two or more currencies, and allow either the debtor or the creditor to decide in which currency the price is to be paid. Under such a clause, only the party having the choice is protected, and the choice may bring the party having the choice unjustified gains.

C. Determining price after conclusion of countertrade agreement

1. Standards

11. [11] The countertrade agreement may provide for a determination of the price through the use of a standard (see chapter IV, "Countertrade commitment", paragraph 44). Such a method provides a price at the time of the conclusion of the supply contract in an objective manner not influenced by the will of the parties.

12. [12] The parties may wish to include a procedure to apply in the event a standard they select proves to be unworkable (e.g., because a market price is not available as expected). For example, the parties may provide that the price is to be determined through the use of an alternate standard or that the price is to be determined by a third person.

(a) Market prices for goods or services of standard quality [title modified]

13. [13] When goods identified in the countertrade agreement are commodities or semi-finished products (e.g., grains, oil, metals, wool) for which prices are regularly reported, the parties may agree to link the price of the countertrade goods to the reported price. Such a linkage to a standard price can also be used for determining the price of services if the service is standard and if there exists a reported price for the service. Such standard services may be, for example, transport; harvesting, cleaning, sorting or packing certain types of goods; or painting of standard surfaces such as ships. Where the price of goods or services is quoted in several markets, the parties are advised to specify a particular market or exchange to which reference will be made. In order to protect against price fluctuations, the standard may call for an average of the prices reported at several agreed points of time (e.g., the prices reported on the first business day of the month for the six months preceding the date of the determination of the price).

(b) Production cost

14. [14] The parties may agree that the price is to be based on the supplier's cost of producing the goods, plus an amount to cover the supplier's overhead and profit. Such an approach may be selected when the exact cost of various inputs cannot be anticipated at the time the countertrade agreement is concluded. In order to limit the purchaser's risk of having to pay an excessive price, it is advisable that, where possible, the parties stipulate

in the countertrade agreement the quantity of inputs (e.g., raw materials, energy and labour) that will be required for the production of one unit of the goods. The parties may also wish to stipulate that the supplier should maintain records reflecting production costs in accordance with forms and procedures required by the purchaser, and that the purchaser shall have access to those records. This approach might be used when the contract to be concluded involves a technological solution that has not been fully developed yet and the exact cost of its development cannot be foreseen.

(c) Competitor's price

15. [15] The price may be determined on the basis of the price charged by an identified competitor producing the same type of goods as those that will be delivered under the supply contract. If the countertrade agreement does not identify the competitor, it may establish criteria for the selection of a competitor (e.g., geographical criteria or criteria related to the volume of production of the same type of goods). Because the competitor may sell a product at different prices in different geographical regions and markets, it is advisable that the countertrade agreement identify the market to which reference will be made. The price clause could also indicate how the price information will be obtained and the date as of which the competitor's price is to be determined. Furthermore, the parties may agree to exclude specially discounted prices charged to certain customers (preferential prices). For example, the standard may exclude prices charged for the goods when they are purchased by disaster relief organizations or by employees of the supplier.

16. [16] A competitor's price may not be relevant, without adjustments, if it is based on a significantly larger or smaller quantity than the quantity intended to be purchased under the countertrade agreement. A competitor's price may also not be appropriate if the competitor's goods are of a different quality, if the competitor's price is based on payment conditions (e.g., deferred payment) not being offered by the supplier of the countertrade goods, or if the amount of transportation costs or insurance and public charges contained in the competitor's price differs from what is to be included in the price of the countertrade goods. It is therefore advisable to stipulate that the standard should take into account only prices for shipments that are comparable in quantity, quality, delivery and payment conditions to the future supply contract, or that amounts should be added to or subtracted from the competitor's price in order to compensate for differences.

17. [17] The parties may agree that the price is to be determined on the basis of several competitors' prices. Such a clause may identify the competitors or it may provide that each of the parties is to obtain quotations from a specified number of competitors. If the competitors are not identified, it is advisable that a clause of this type specify the countries or regions from which the parties are to obtain the quotations. It is also advisable that the countertrade agreement indicate the manner in which the price is to be calculated (e.g., whether by calculating a mean or a median price). The parties may wish to specify the period of time during which the quotations are to be obtained. In doing so, the parties should take into account the length of time necessary to obtain the quotations as well as the need to base the calculation on current prices.

18. [18] When the party committed to purchase goods manufactures the same type of goods, the parties may agree that the price will be determined on the

basis of the price charged by the purchaser or on the basis of the purchaser's own cost of manufacture. Such an approach might be used, for example, in a buy-back transaction in which a producer of a certain type of goods sells a facility that produces that type of goods and agrees to buy back the resultant products.

(d) Most-favoured-customer clause

19. [19] It may be agreed that the price of the countertrade goods will be based on the lowest price at which goods of the same type are supplied by the supplier to other customers. In some cases, the parties may restrict the clause to a limited category of customers (e.g., customers in a particular country or customers identified in the countertrade agreement). The parties may wish to indicate the means to be used to identify the most-favoured customer. For example, the supplier could be required to provide specified types of information indicating the prices charged by the supplier to other customers. It is also advisable to ensure that the most-favoured-customer price is relevant to the shipments to be made pursuant to the countertrade agreement (see above, paragraph 16). The parties may also wish to specify the date as of which the most-favoured-customer price is to be determined. The parties may wish to specify any specially discounted prices (preferential prices) offered by the supplier to certain customers that should not be taken into account (see above, paragraph 15). The scope of the most-favoured-customer clause may be broadened by agreeing that the price will be determined on the basis of the lowest price charged by the supplier or by other specified suppliers of the same type of goods.

(e) Use of more than one standard

20. [20] The countertrade agreement may provide that the price is to be determined by a formula involving two or more standards. For example, the price may be determined by averaging the prices derived from the selected standards. Another possibility is for the price derived from a particular standard to be compared with prices derived from one or more other standards. If the difference between the price derived from the selected standard and the prices from the comparator standards does not reach a specified threshold, the price derived from the selected standard would apply. If the difference exceeds a specified threshold, the final price would be, for example, the average of the price derived from the standards. Such techniques may be useful when it is desired to avoid the possibility that the price derived through the use of a single standard might not reflect the market value of a given product at the time the purchase is to be made.

2. Negotiation

21. [21] The parties may stipulate in the countertrade agreement that the price to be paid under the future supply contract will be negotiated at a time subsequent to the conclusion of the countertrade agreement. It is advisable that, to the degree possible, the parties agree on guidelines for the determination of the price. (For a discussion on procedures for the negotiations, and on guidelines for the determination of the price, see chapter IV, "Countertrade commitment", paragraphs 44 to 46, and 57 to 60).

22. [22] Guidelines for the determination of the price may establish minimum and maximum limits within which the price is to be negotiated. In

establishing such limits, the parties may use price standards of the type described above in paragraphs *11 to 20*. For example, it may be agreed that the price should not be more than 5 per cent higher or more than 5 per cent lower than the price charged by a competitor.

23. [23] Alternatively, guidelines may merely provide a reference price to be taken into account in negotiations. In formulating a guideline of this type, the parties may use price standards such as those described above in paragraphs *11 to 20*. For example, it may be agreed that the price will be negotiated taking into account the price of a particular competitor.

24. [24] A negotiation guideline may also take the form of a statement that the price of goods is to be "competitive", "reasonable", or at a "world market" level. Such a clause might be acceptable when the goods are of a standard quality. A guideline of this type may be made more precise by specifying, for example, whether the price should be based only on prices paid to the supplier by other buyers or should also be based on prices charged by other suppliers, the period of time the parties should refer to in determining what is a "competitive", "reasonable" or "world market" price, and, if there are variations in prices in different markets, which markets, types of buyers or geographical territories are referred to.

3. Determination of price by third person

25. [25] Sometimes the parties provide for the price to be set by an independent third person (e.g., a market specialist in the goods in question). For a discussion of determination of contract terms by third persons, see chapter *IV, "Countertrade commitment"*, paragraphs *47 to 54*. Such an approach *may be used in combination with a clause on price setting by negotiation so that the determination of the price would be entrusted to a third person in the event that the parties failed to negotiate a price.*

26. [26] The countertrade agreement *should* delimit the mandate of the third person by providing guidelines of the type discussed with respect to negotiation (above, paragraphs *21 to 24*). The parties may wish to establish deadlines for referral of the matter to a third person, so that the price could be set in time to allow conclusion of contracts as planned.

4. Determination of price by one party

27. [27] Sometimes it is agreed that the price will be determined by one of the parties to the countertrade agreement. *Utmost caution is advisable in agreeing on such a solution, since it leaves the determination of the price to a person who is interested in the outcome of the determination. In many legal systems an agreement of this type is not enforceable. (For further discussion, see chapter IV, "Countertrade commitment", paragraphs 55 and 56.)*

D. Pricing of services

28. [*new paragraph*] When the parties determine in the countertrade agreement a service as the subject-matter of the future supply contract (e.g., maintenance, repair, transport, construction services), it is advisable for the parties to settle in the countertrade agreement, to the extent possible, certain questions relating to the price of the services. By doing so, the

parties may facilitate negotiations for the conclusion of the envisaged supply contract.

29. [new paragraph] Various approaches may be used in setting the price for services. One approach is to agree on unit rates for units of work processes involved. The units may be, for example, a quantity unit of the result (e.g., a square meter of paint work, kilometer of transport of goods, cubic meter of excavated material, hour of labour). This approach may be appropriate when the services in question are of a routine character or when the quantity of the services needed cannot be envisaged accurately at the time of entering into the countertrade agreement. If there is no provision for a revision of the unit price in the event of changes in unit costs, the risk of increases in costs and benefits arising out of decreases in costs are divided between the parties. The supplier bears the risk of an increase of the costs of materials and labour for each unit or receives the benefit of a decrease in those costs.

30. [new paragraph] Another approach is for the price to be expressed as a lump sum payable for the specified service. Under this method, the purchaser knows the total price of the service, and the supplier bears the risk of increases in the cost of the service and benefits if the cost turns out to be lower than anticipated. Since the lump-sum price may include an amount to compensate the supplier for bearing the risk of cost increases, the price may be higher in some cases than if the cost-reimbursable pricing method were used for the same service (see the following paragraph). In addition, the lump-sum pricing method requires a precise specification in the contract of the scope of the service. It might be advisable for the purchaser to address in the countertrade agreement the manner of monitoring the performance by the supplier to ensure that the contractor does not reduce its costs by using substandard materials or working methods.

31. [new paragraph] Yet another approach may be to stipulate that the supplier of the service is to be paid a fee to cover its overhead and profit, and that the supplier is to be compensated for its expenses on a cost-reimbursable basis. It is desirable for the countertrade agreement to specify clearly which costs are reimbursable and which are to be borne by the supplier out of its fees. Reimbursable expenses might be, for example, wages of personnel directly involved in the performance of the contract, routine items of materials or equipment used in performing the service, or costs incurred in employing specified types of subcontractors. Usually, the solution providing each party a better opportunity to foresee its costs is to enumerate the costs to be reimbursed and to provide that all other costs are to be borne by the supplier; sometimes, however, the parties decide to enumerate the costs that are not reimbursable and provide that all other reasonable costs are to be reimbursed.

E. Pricing of technology transfer

32. [new paragraph] Sometimes the countertrade agreement envisages the future conclusion of a supply contract that includes the transfer of technology (see chapter VI, "Type, quality and quantity of goods", paragraphs 16 to 23). In such cases, it is advisable for the parties, to the degree possible, to address in the countertrade agreement a variety of questions particular to the pricing of technology. Settling such questions in

the countertrade agreement may facilitate finalization of the supply contract involving the transfer of technology. Those questions, discussed in the following paragraphs, are analysed in publications dealing with transfer of technology generally. 1/

33. [new paragraph] The two principal forms of pricing of technology transfers are the lump-sum payment or payment of royalties. In the lump-sum method, the total price is determined at the outset. Among the key questions raised by this method are the time of payment and whether it is to be paid in one payment or in instalments. Under the law of some countries, the use of the lump-sum method may be subject to certain conditions. These conditions may, for example, restrict the types of transfers (e.g., purchase of patent rights or specified types of technical services and assistance) or sectors in which the lump-sum method may be used; they may also prescribe the basis on which the lump sum is be calculated and require a special governmental authorization.

34. [new paragraph] If the royalty method is used, the price payable (i.e., the royalty) is fixed by reference to some economic result of the use of the transferred technology. The law of some countries mandates the use of the royalty method of payment in certain types of industrial property licenses or technology transfer agreements). The royalty is typically linked to the production, sales, or profits arising from the use of the technology. Where the volume of production is used as the reference factor, the royalty may be determined, for instance, as a fixed amount per unit or quantity (e.g., per ton or per litre) produced. The law of some countries restricts the freedom of parties to agree on royalties based on production. For example, it may be required that for certain types of licenses or technology transfers royalties should be linked to sales volume.

35. [new paragraph] The linkage of royalties to sales has the advantage of not imposing on the transferee of the technology liability for payment of royalties for goods that have been produced but not sold. Parties wishing to use this approach must decide whether the royalty is to be based on the gross or on the net selling price. The latter method provides the possibility of excluding from the calculation of the royalty a number of items that are included in the sales price but which are unrelated to the technology or already have been a source of profit for the transferor. These might include, for example, packing expenses, taxes, transport and insurance costs, cost of raw-materials, and the percentage of the price covering the royalties. The law of some countries may define the permissible range of elements that may be included in the net selling price. Furthermore, the parties may wish to stipulate that the royalty is to be based on the fair market price of the product. Such an approach may be used to guard against a diminution in the level of the economic return achieved by the transferor that would result were the transferee to sell the products in question at a low price to a party with whom the transferee had a special relationship. Various methods exist in turn for defining the fair market price. Other questions raised by the linking of royalties to sales include the point of time when the product is deemed sold and the time when the remittance of the royalty becomes due.

36. [new paragraph] Another basis for the calculation of royalties is to link royalties to profits obtained by the transferee from the exploitation of the technology transferred. Other approaches to the calculation of royalties include minimum royalty arrangements, in which a minimum payment is due

irrespective of whether a given level of production, sales or profits has been achieved, decreasing royalty arrangements, in which the amount of the royalty decreases as production or sales increase, and maximum limits on the amount of royalties due. The use of certain of these arrangements may, in some cases, be mandated, and, in other cases, restricted, under the law of some countries. For example, in some countries, minimum royalty arrangements may not be permitted when royalties are linked to production, sales or profit, decreasing royalties might be mandated, and maximum royalty limits imposed for certain types of technology transfers. The attention of the parties should also be directed to the question of which of the parties is to be liable for payment of taxes on the royalties. It should be noted that the laws of some countries regulate this question (e.g., the parties may be required to stipulate in the contract for the transfer of technology who is to pay taxes).

37. [new paragraph] When considering whether to use the lump-sum or the royalty method, the parties should bear in mind, in addition to provisions of the applicable law, that each method of price calculation may have certain advantages and disadvantages in the light of the type of transaction and the economic circumstances involved. If, for example, royalties are payable over a long time, economic circumstances may change during this period affecting the volume of sales, and consequently the royalties payable; in a joint venture in which the transferor is a partner, it might be considered that a royalty linked to sales would be preferable to a lump-sum arrangement because of the added motivation provided to the transferor to develop sales. In some cases, it may be desirable to combine the two methods (e.g., an initial lump-sum payment followed by payment of royalties). The particular manner in which a royalty arrangement is structured would likewise have to reflect the economic circumstances and contractual obligations involved. For example, if the licensor or technology transferor is to assist in sales of the products resulting from the transfer of the technology, caution might be advisable in applying a decreasing royalties arrangement since such an arrangement might have the unintended effect of discouraging the transferor from expending fully its efforts in the direction of increasing sales. Where royalties are to be paid, the parties would typically agree on a method of reporting the variable data (e.g., volume of production, sales or profits) which serve as the basis for calculating the royalty. Provision is usually made for the transferee to keep certain records and for the transferor to be given an opportunity to review those records.

38. [new paragraph] In negotiating the technology pricing clause, the question might arise whether any separate fees should be payable for specific technical services and assistance to be provided by the transferor of technology. Such services and assistance may include, for example, training programmes for the personnel of a patent or trademark licensee, technical experts furnished by the licensor or transferor, various technical services relating to the purchase of capital goods, and management, planning, research and development services. Some countries have provisions relating to that question.

F. Revision of price

39. [28] When multiple shipments are spread out over a period of time, there may be a need to revise the price in order to reflect changes in the

underlying economic conditions. It may be agreed that a revision would occur at specified points of time. Those points of time should be coordinated with the schedule for the fulfilment of the countertrade commitment (e.g., the revision is to take place four weeks prior to the commencement of a subperiod).

40. [29] Under another approach, it may be agreed that a revision would take place in response to specified changes in underlying economic conditions (e.g., an exchange rate fluctuation beyond a certain percentage from a reference rate in effect on the date the countertrade agreement was concluded or changes beyond an agreed threshold in specified components of production cost such as raw materials or labour). Contractual provisions concerning price revision due to a change in the value of the currency in which the price is to be paid are mandatorily regulated under some legal systems. The parties should, therefore, examine whether a clause which they intend to include in the countertrade agreement is permitted under the law of the country of each party.

41. [30] Yet another approach is to provide for a price revision at regular intervals (e.g., every six months), as well as for unscheduled revisions in response to specified changes in underlying economic conditions. In order to limit the frequency of price revision, it could be agreed that an unscheduled review could not take place within a specified period of time following a review, or within a specified period of time preceding a scheduled review. Yet another approach would be to set the price revision procedure in motion upon the delivery of a specified portion of the total quantity of goods to be purchased.

42. [31] The countertrade agreement might provide for the price revision clause to apply only in cases where its application would result in a revision exceeding a certain percentage of the price.

43. [32] When the countertrade agreement contains a price revision clause, the parties may wish to specify the shipments to which the revised price is to apply. It may be agreed, for example, that the applicable price for a given shipment is the price in effect on the date the goods are ordered or on the date the letter of credit is issued.

1. Reapplication of price clause

44. [33] The parties may stipulate in the countertrade agreement that the price is to be revised through the use of the same method as was employed to determine the initial price (standards (paragraphs 11 to 20), negotiation (paragraphs 21 and 24), determination of price by a third person (paragraphs 25 and 26) or determination of price by one party (paragraph 27)).

2. Index clause

45. [34] The purpose of index clauses is to revise the price of the countertrade goods by linking the price to the levels of the prices of certain goods or services prevailing on a certain date. Usually the linkage is to the price of raw materials or services used in the production of the countertrade goods. A change in the agreed indices automatically effects a change in the price. In formulating an index clause, it is advisable to use an algebraic

formula to determine how changes in the specified indices are to be reflected in the price. Several indices, with different weightings given to each index, may be used in combination in the formula in order to reflect the proportion of different cost elements (e.g., materials or services) to the total cost of the goods. Different indices may be contained in a single formula to reflect the costs of different types of materials and services. When the sources of the same cost element (e.g., labour or energy) are in different countries, different indices may be found in a single formula for that cost element.

46. [35] Several factors may be relevant in deciding on the indices to be used. The indices should be readily available (e.g., they should be published at regular intervals). They should be reliable. Indices published by recognized bodies (such as chambers of commerce, or governmental or inter-governmental agencies), may be selected. The parties should exercise caution in using indices based on different currencies in a formula, as changes in the relationships between the currencies may affect the operation of the formula in unintended ways.

47. [36] In some countries, particularly in developing countries, the range of indices available for use in an index clause may be limited. If an index is not available for a particular element of costs, the parties may wish to use an available index in respect of another element. It is advisable to choose an element whose price is likely to fluctuate in approximately the same proportions and at the same times as the actual element to be used. For example, in cases where it is desired to provide an index for labour costs, a consumer price index or cost-of-living index is sometimes used if there is no wage index available.

3. Change in exchange rate of currency in which price is payable

(a) Currency clause

48. [37] Under a currency clause, the price to be paid is linked to an exchange rate between the currency in which the price is to be paid and a certain other currency (referred to as the "reference currency") determined at the time of entering into the countertrade agreement. If this rate of exchange has changed at the time of payment, the price to be paid is increased or decreased in such a way that the amount of the price in terms of the reference currency remains unchanged. For purposes of determining the applicable exchange rate, it may be desirable to adopt the time of actual payment, rather than the time when the payment falls due. If the latter time is adopted, the supplier may suffer a loss if the purchaser delays payment. Alternatively, the supplier may be given a choice between the exchange rate prevailing at the time when payment falls due or that prevailing at the time of actual payment. It is advisable to specify an exchange rate prevailing at a particular place.

49. [new paragraph] The intention of a currency clause is typically to stabilize the international purchasing power of the amount to be paid pursuant to the contract. Therefore, a currency clause may not operate as intended if the exchange rate between the currency in which the price is to be paid and the reference currency is set by administrative decisions independent of events taking place in the currency market.

50. [38] The reference currency should be stable. The insecurity arising from the potential instability of a single reference currency may be reduced by reference to several currencies. The contract may determine an arithmetic average of the exchange rates between the currency in which the price is payable and several other specified currencies, and provide for revision of the price in accordance with changes in this average.

(b) Unit-of-account clause

51. [39] If a unit-of-account clause is used, the price is denominated in a monetary unit of account composed of cumulative proportions of a number of selected currencies. In contrast to a clause in which several currencies are used (above, paragraph 50), the weighting given to each selected currency of which such a monetary unit of account is composed is usually not the same, and greater weight is given to currencies generally used in international trade. The unit of account may be one that is established by an intergovernmental institution or by agreement between two or more States and that specifies the selected currencies making up the unit and the relative weighting given to each currency (e.g., Special Drawing Right (SDR), European Currency Unit (ECU), or Unit of Account of the Preferential Trade Area for Eastern and Southern African States (UAPTA)). In choosing a unit of account, the parties should consider whether the relation between the currency in which the price is payable and the unit of account can be easily determined at the relevant times, i.e., at the time of entering into the supply contract and at the time of actual payment.

52. [40] The value of a unit of account composed of a basket of currencies is relatively stable, since the weakness of one currency of which the unit of account is composed is usually balanced by the strength of another currency. The use of such a unit of account will therefore give substantial protection against changes in exchange rates of the currency in which the price is payable in relation to other currencies.

Note

1/ The different methods of determining the price payable for technology are considered in detail in the Licensing Guide for Developing Countries (WIPO) and in Guidelines for Evaluation of Transfer of Technology (UNIDO); see footnote 1 in chapter VI, "Type, quality and quantity of goods".